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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 199

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SAMUEL F. HOUSTON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 14, 1930
CERTIORARI GRANTED OCTOBER 13, 1930

SUPREME COURT OF THE UNITED STATES

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vs.

SAMUEL F. HOUSTON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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1 Before United States Board of Tax Appeals

SAMUEL F. HOUSTON, PETITIONER
v.
COMMISSIONER OF INTERNAL REVENUE
Docket No. 11832

Appearances: For taxpayer, Wm. Clark Mason, Esq., J. C. Peacock, Esq., W. C. Alexander, Esq. For comm'r., A. H. Murray, Esq., J. F. Greaney, Esq., Oscar M. McPeak, Esq.

Docket entries

Feb. 9, 1926. Petition received and filed.
Feb. 17, 1926. Copy of petition served on solicitor.
Feb. 17, 1926. Notification of receipt mailed taxpayer.
Apr. 16, 1926. Answer filed by solicitor.
Apr. 22, 1926. Copy of answer served on taxpayer. General calendar.
May 6, 1927. Motion for a consolidation with Dockets #11807 and 11833 filed by taxpayer. See 11807.
May 7, 1927. Granted. Both sides notified.
Dec. 6, 1927. Hearing date set Jan. 30, 1928.
Jan. 30, 1928. Hearing had before Mr. Littleton on petitioner's motion for continuance. Granted to Feb. 28, 1928.
2 Jan. 30, 1928. Order of continuance to Feb. 28, 1928, entered.
Feb. 23, 1928. Motion for a continuance of one month, filed by taxpayer. See 11807.
Feb. 26, 1928. Motion granted to March 27, 1928.
Mar. 27, 1928. Hearing had before Mr. Murdock on merits. Submitted. Briefs due June 15, 1928.
Apr. 13, 1928. Transcript of hearing of March 27, 1928, filed.
June 15, 1928. Brief filed by taxpayer.
June 15, 1928. Brief filed by general counsel. See 11807.
Aug. 28, 1928. Findings of fact and opinion rendered (Murdock). Judgment will be entered for the commissioner.
Aug. 29, 1928. Order of redetermination entered.
Feb. 23, 1929. Supersedeas bond for $383,661.06 approved and ordered filed.
Feb. 23, 1929. Petition for review by U. S. Circuit Court of Appeals (3) with assignment of error filed by taxpayer with proof of service thereon.
Apr. 17, 1929. Præcipe of record filed by taxpayer.
Apr. 17, 1929. Statement of evidence lodged by taxpayer.
Apr. 19, 1929. Motion for extension to June 1, 1929, to prepare statement of evidence and transmit record filed by general counsel.
3 Apr. 20, 1929. Order extending time to June 1, 1929, to prepare evidence and to transmit and deliver record papers sur petition for review, entered.

May 29, 1929. Motion for extension to July 1, 1929, to prepare and deliver record, filed by general counsel.
June 1, 1929. Order enlarging time to July 1, 1929, for preparation of evidence and delivery of record papers, entered.
June 26, 1929. Agreed statement of evidence lodged. Approved and ordered filed June 27, 1929.
July 1, 1929. Order enlarging time to July 15, 1929, for transmission and delivery of record papers, entered.
July 2, 1929. Proof of service of præcipe filed.

Now, July 1, 1929, the foregoing docket entries certified from the record as a true copy.

[SEAL] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

4 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed February 9, 1926

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (bureau symbols IT:PA:2-60D—DMR:203), dated December 18, 1925, and as the basis of this appeal sets forth the following:

JURISDICTION OF THE BOARD

1. The taxpayer is an individual residing at Druim Moir, Chestnut Hill, Philadelphia, Pennsylvania.

2. The deficiency letter (a copy of which is attached) was mailed to the taxpayer on December 18, 1925, and states a deficiency of $191,830.53.

3. The taxes in controversy are income tax and surtax for the calendar year 1920 and are more than $10,000, to wit: $191,830.53.

ASSIGNMENT OF ERROR

4. The determination of tax contained in the said deficiency letter is based upon the following error:

The Commissioner of Internal Revenue erred in failing to allow as a deduction from the gross income of the taxpayer in the year 1920 a loss amounting to $271,700, incurred by the taxpayer in a transaction entered into for profit in the year 1906, which was terminated
5 in the year 1920, and the share of the proceeds received by the taxpayer in that year determined the amount of his loss, which was charged off upon his books in 1920.

5. The Real Estate Trust Company of Philadelphia closed its doors in the year 1906, and George H. Earle, jr., was appointed receiver by the Court of Common Pleas No. 4, of Philadelphia County, Pennsylvania, on August 28, 1906.

The financial embarrassment of the Real Estate Trust Company was due to the use of its funds by Frank K. Hipple, president, in the financing of certain projects promoted by Adolph Segal, and the taking of collateral for loans to Segal of a character which did not permit of ready liquidation, but had potential values substantially in excess of the amount of the loans.

The receiver promulgated a plan of reorganization which included, as one of its provisions, the creation of a fund of $2,500,000 by the directors of the company to guarantee a value for the Segal collateral, designated in the plan "Segal matters," upon the terms and conditions set forth in this plan.

Samuel F. Houston, the taxpayer, who was one of the directors, subscribed in cash to the so-called guarantee fund the sum of $755,000, and when the plan became effective by the required consents of creditors, stockholders, and others, and the subscribers to this fund were called upon to make payment of the subscriptions, the taxpayer found that a payment by him of the full amount of his subscription would necessitate the sacrifice of securities and investments in the then existing market to the point of considerable loss to him, and he made a proposal to his sisters, Sallie H. Henry and Gertrude
6 Houston Woodward, that they take a participating interest in his subscription to the extent of $200,000 and $150,000, respectively.

The plan of reorganization, in so far as it related to the "Segal matters," provided (par. 4) that "The contributors to the $2,500,000 fund made such contribution with the understanding that if these 'Segal matters' shall be so administered as to realize an amount which would make the capital and apparent surplus whole, they should receive from the company any excess over this amount."

The two sisters of the taxpayer accepted his proposal and joined with him in subscribing to the fund in the aggregate sum of $755,000, of which the taxpayer subscribed $305,000. These subscriptions were made upon the expectation and belief, founded upon the representations which had been made to the taxpayer at the time, that he and his sisters would receive a return of the contributions in full and a participation in the excess to be realized from the administration of the "Segal matters," subject only to reasonable business risks incident to the administration of such assets.

The plan of reorganization became effective, the Real Estate Trust Compnay of Philadelphia resumed business, and the "Segal matters" were administered by the compnay under the direction of

George H. Earle, jr., formerly receiver, and thereafter president of that company.

The taxpayer was advised from time to time of the progress of the administration of the "Segal matters," and was familiar with and consented to a certain agreement entered into by the Real Estate Trust Company and the committee of the contributing directors, of which the taxpayer was one, as of May 5, 1916.

This agreement was supplemental to the original agreement under which the subscriptions were made and resulted from the
7 opinion of John G. Johnson, Esq., of July 15, 1915, as to the rights of the several parties to the original plan of reorganization.

The supplemental agreement of May 5, 1916, recognized the potential value of the "Segal matters" to produce for the parties interested in the "Segal matters" the amount of their original subscriptions with interest thereon, and provided a schedule for the payment of principal and interest by the Real Estate Trust Company, as the administrator of the assets, in the following language:

"Third. That out of any income or dividends received hereafter by the Real Estate Trust Company of Philadelphia during each calendar year from such assets as are not already disposed of, five per cent per annum shall be first paid to the said the Real Estate Trust Company of Philadelphia, but not cumulatively, upon such balance of said $3,000,000.00 as remains unliquidated from time to time; three per cent per annum, but not cumulatively, shall be next paid upon any balance of said $2,505,000.00, remaining unreturned, pro rata and proportionately, to the contributors of the said $2,505,000.00 fund; and if there be any further remainder of such income in any such year, it shall be applied, first, to and towards the entire liquidation of the remainder of the $3,000,000.00 first due from such assets as aforerecited to the Real Estate Trust Company of Philadelphia; and when that is completely liquidated, then any remainder shall be applied to and towards the entire liquidation of the remainder of the $2,505,000.00 due secondly to the said contributors, without interest."

The further liquidation of the "Segal matters" progressed under the administration of the Real Estate Trust Company until the year 1920, when the parties concerned, after full investigation, were of opinion that the liquidation agreement had rendered its maximum of
8 service, and that the values shown in the latter part of 1920 for the remaining Segal assets were the maximum which such assets would have for a substantial period of time to come.

The parties, by their duly constituted representatives, or in person, thereupon entered into an agreement as of December 30, 1920, whereby it was provided for a complete liquidation of the "Segal matters" by a distribution in kind.

The taxpayer received, in accordance with the terms of the said agreement, 548.734 shares of the common stock of the Pennsylvania

Sugar Company in full and complete satisfaction and discharge of his interest in the "Segal matters."

That of the said 548.734 shares of the common stock of the Pennsylvania Sugar Company received by the taxpayer, 222 shares thereof, represented his proportion, and the remaining shares, by reason of the agreement between himself and his sisters, were received by him on their account and were accounted for by him to them in satisfaction of their subscriptions to the fund.

The market value of the said shares at the time of the receipt thereof by this taxpayer was not in excess of $150 per share, and the aggregate value thereof, as credited by the taxpayer against his original subscriptions to the fund guaranteeing the "Segal matters," and the difference, representing the actual loss ascertained in the year 1920, was written off as a loss on the books of the taxpayer in the amount of $271,700.

The subscriptions made by the directors of the Real Estate Trust Company and their associates to the fund aforesaid, in accordance with the plan of reorganization, varied in amounts, and were not in proportion to their stock holdings in the Real Estate Trust Company, but had great variance therefrom.

9 The final accounting of the administration of the "Segal matters" by the Real Estate Trust Company was rendered in 1920, when the administration of that trustee terminated and distribution was made among the subscribing directors, and prior thereto no apportioned value was given or could have been given to the interest of the taxpayer in the "Segal matters" which was secured to him by his subscription to the fund created in 1906.

STATEMENTS OF PROPOSITIONS OF LAW

6. The taxpayer contends that the unit should permit a deduction of the actual loss sustained by the taxpayer as a result of the transaction above set forth as claimed, because at the time the original payment was made in 1906 of cash in excess of the loss claimed, there was reasonable expectation of a profit or at least a return of the amount contributed to the reorganization fund. The ascertainment of the actual loss to the taxpayer was in the year 1920, when it was charged off by the taxpayer to the extent claimed upon the books of account kept by the taxpayer for that year. The act of Congress applicable to the year in question permits deduction of "losses sustained" and this language would seem to justify the deduction in the year aforesaid of what was then definitely ascertained to be the actual money loss sustained by the taxpayer resulting from the transaction referred to herein.

Wherefore, the taxpayer respectfully prays that this board may hear and determine his appeal.

(Sgd.) WM. CLARK MASON,
Counsel for Taxpayer.

10 [*Duly sworn to by Samuel F. Houston jurat omitted in printing.*]

Exhibit A to petition

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Dec. 18, 1925.

IT:PA:2-60D.
DMR:203.

Mr. SAMUEL F. HOUSTON,
Druim Moir, Chestnut Hill, Philadelphia, Pennsylvania.

SIR: The determination of your income tax liability for the year 1920, as set forth in office letter dated June 2, 1924, disclosed a deficiency in tax amounting to $191,830.53.

11 In accordance with the provisions of section 274 of the revenue act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal contesting in whole or in part the correctness of this determination. Any such appeal must be addressed to the United States Board of Tax Appeals, Washington, D. C., and must be mailed in time to reach that board within the 60-day period.

Where a taxpayer has been given an opportunity to appeal to the Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:PA:2-60D:DMR:203. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR,
Commissioner,
By C. R. NASH,
Assistant to the Commissioner.

Inclosures:
Statements.
Agreement—Form A.

12 Statement

IT:PA-2-60D.
DMR-203.

In re: Mr. Samuel F. Houston, Druim Moir, Chestnut Hill, Philadelphia, Pennsylvania.

1920 Deficiency in Tax—$191,830.53

Since bureau letter dated June 2, 1924, was mailed, your protest against the disallowance of the alleged loss of $271,700.00 has been

given due consideration by the Solicitor of Internal Revenue, who has held that no deductible loss was incurred by any of the directors of the Real Estate Trust Company on account of the contributions made by them in connection with the reorganization of such company.

Now July 1, 1929, the foregoing petition certified from the record as a true copy.

(Sgd.) B. D. GAMBLE,
[SEAL.] *Clerk, U. S. Board of Tax Appeals.*

Before United States Board of Tax Appeals

Answer

Filed April 16, 1926

The Commissioner of Internal Revenue by his attorney, A. W. Gregg, Solicitor of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

(1) Admits the allegations of paragraph 1 of the petition.

(2) Admits the allegations of paragraph 2 of the petition.

13 (3) Admits the allegations of paragraph 3 of the petition.

(4) Admits that the commissioner did not allow as a deduction from gross income for 1920 an amount of $271,700 representing an alleged loss incurred in a transaction entered into in 1906 and claimed to have terminated in 1920.

(5) Admits that the Real Estate Trust Company of Philadelphia closed its doors in the year 1906, and George H. Earle, jr., was appointed receiver.

Admits that the financial embarrassment of the trust company was due to the use of its funds by Frank K. Hipple, its president, in the financing of certain projects promoted by Adolph Segal, and the taking of collateral for loans to Segal of an uncertain value.

Admits that the receiver promulgated a plan of reorganization which included, as one of its provisions, the creation of a fund of $2,500,000 by the directors of the company for the use of the company under the terms and conditions set forth in the plan, and that the Segal collateral was referred to in the said plan as "Segal matters."

Admits that Samuel F. Houston, the taxpayer, who was one of the directors, subscribed in cash to the said fund the sum of $755,000, and that his sisters, Sallie H. Henry and Gertrude Houston Woodward, in response to the taxpayer's proposal, furnished the amounts of $200,000 and $150,000, respectively, of the subscription made by the taxpayer, and assumed a participating interest in the said subscription and the rights of the taxpayer thereunder to the extent of said amounts furnished by them.

Admits that the plan of reorganization provided that the contributions of the directors were made with the understanding that if the Segal matters should be so administered as to realize an

14 amount which would make the capital and apparent surplus whole, which were assumed to be $3,000,000, the contributors should receive any excess over this amount.

Admits that the taxpayer furnished $305,000 of his subscription. Denies that the subscriptions were made in reliance upon representations that the contributors would receive a return of their contributions in full and would then participate in an excess, and denies that such contributions were made with the idea that they were subject only to reasonable business risks.

Admits that the plan of reorganization became effective, the Real Estate Trust Company resumed business, and the Segal matters were administered by the company under the direction of George H. Earle, jr., formerly receiver, and thereafter president of the company.

Admits that the taxpayer was familiar with and consented to a certain agreement entered into by the trust company and the contributing directors as of May 5, 1916.

Admits that this agreement was supplemental to the original agreement under which the subscriptions were made, and that in connection with the making of said agreement, the parties procured an opinion of John G. Johnson, Esq., as to the rights of the several parties to the original plan of reorganization.

Admits that the said supplemental agreement of 1916 provided for the payment of principal and interest to the trust company and the contributors, and that under said agreement, out of any income or dividends received thereafter by the trust company in each year from such assets of the Segal matters as were not already disposed of, five per cent should be first paid to the trust company upon the balance of the former assumed capital and surplus of $3,000,000 remaining unliquidated, and three per cent should next be paid
15 to the contributors upon any balance of the fund of $2,505,000 remaining unreturned, and that further income in each year should be applied first to the liquidation of any balance of the trust company's $3,000,000, and after complete liquidation of said amount, the remainder should be applied to the liquidation of the $2,505,000 due the contributors.

Admits that in the year 1920, the parties concerned agreed to terminate the agreement and dispose of the assets on hand.

Admits that the parties entered into an agreement in 1920 for the complete liquidation of the Segal matters by distribution in kind.

Admits that pursuant to this agreement, the taxpayer received, as his share of said assets, 548.734 shares of the common stock of the Pennsylvania Sugar Company in full settlement of his interest in the Segal matters.

Admits that of the said 548.734 shares, 222 shares represented the portion of said assets to which the taxpayer was entitled by reason of his contribution, and the remainder of said shares belonged to his sisters under the agreement made between them.

Admits that the taxpayer claimed a value for said shares of $150 a share, and claimed as a loss in the year 1920 the difference between

his original contribution and the aggregate value of his shares computed on a basis of $150 a share, the amount of said difference being $271,700.

Admits that the subscriptions made by the directors of the trust company to the fund aforesaid varied in amounts and were not in proportion to their stock holdings in the trust company.

Admits that the final accounting of the administration of the Segal matters by the trust company was made in 1920.

Denies that the taxpayer is entitled to a deduction for a loss
16 of $271,700 on account of the transaction aforesaid. Denies that the taxpayer entered into said transaction in 1906 for profit. Denies that the taxpayer sustained a loss on said transaction based on the March 1, 1913, value of the Segal matters and denies that the taxpayer sustained any loss whatever under the revenue act of 1918. Denies that the taxpayer sustained any loss in 1920. Denies that said shares of Pennsylvania Sugar Company had a value of no more than $150 a share.

(6) Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal of the taxpayer be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:
JOHN W. FISHER,
Special Attorney, Bureau of Internal Revenue.

Now July 1, 1929, the foregoing answer certified from the record as a true copy.

[SEAL.] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

17 Before United States Board of Tax Appeals

J. I. R. HENRY, EXECUTRIX OF THE ESTATE of Bayard Henry, deceased, Samuel F. Houston, Mrs. Sallie H. Henry, William W. Porter, petitioners *v.* COMMISSIONER OF INTERNAL REVENUE, respondent	Docket Nos. 11807, 11832, 11833, 12734

Findings of fact and opinion

Filed August 28, 1928

A taxpayer who entered into a transaction prior to March 1, 1913, by which he acquired certain rights at a certain cost, but who offers no proof of the March 1, 1913, value of the rights or of its compari-

son with cost has not established the basis for a loss on the final disposition of those rights in 1920 or 1921 for a certain amount.

The commissioner may in his discretion reconsider any taxpayer's liability to income and profits taxes originally decided by him at any time within the period of the statute of limitations subject only to the provisions of sections 1309 and 1312 of the revenue act of 1921 and corresponding sections of subsequent revenue acts as the same may be applicable.

William Clarke Mason, Esq., James Craig Peacock, Esq., and William C. Alexander, Esq., for the petitioners.

J. F. Greaney, Esq., and Oscar M. McPeak, Esq., for the respondent.

18 The commissioner determined deficiencies as follows:

Name	Year	Amount of deficiency
Bayard Henry	1921	$2,891.56
Samuel F. Houston	1920	$191,830.53
Mrs. Sallie H. Henry	1921	$100,870.20
William W. Porter	1921	$7,268.60

Each petitioner alleges that the commissioner erroneously failed to allow as a deduction a loss sustained arising out of the failure of the Real Estate Trust Company of Philadelphia.

In the case of Samuel F. Houston, the loss was alleged to have been sustained in the year 1920, and in the case of each of the other petitioners, the loss was alleged to have been sustained in the year 1921. In the case of William W. Porter an additional error was alleged as follows:

"The Commissioner of Internal Revenue having approved ruling of the Solicitor of Internal Revenue upon a point of law under date of August 21, 1923, wherein the deduction heretofore claimed was allowed, and having made a refund to the taxpayer of the amount of the deficiency herein, is not authorized to review and annul said ruling in the absence of fraud or mistake."

J. I. R. Henry, executrix, has been substituted as the petitioner in place of Bayard Henry, deceased.

The cases were consolidated.

FINDINGS OF FACT

The petitioners, Samuel F. Houston, Sallie H. Henry, and William W. Porter, are individuals residing at Philadelphia, Pa.

Bayard Henry was an individual residing at Germantown, Philadelphia, Pa. He died on September 17, 1926, and J. I. R. Henry is the duly constituted executrix of his estate.

19 The Real Estate Trust Company of Philadelphia closed its doors in the year 1906, and on August 28th of that year George H. Earle, jr., was appointed receiver for it by the Court of Common Pleas of Philadelphia County, Pennsylvania. The financial embar-

rassment of the Real Estate Trust Company was brought about by the improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to Adolph Segal and took therefor collateral which could not be easily liquidated but which was not without value. He also wrongfully permitted Segal to withdraw certain of this collateral for the purpose of placing it as collateral for loans from other sources.

The receiver for the Real Estate Trust Company proposed a plan of reorganization for that company which included as one of its provisions the creation of a fund of $2,500,000 from subscriptions by directors of the company to guarantee a value of $3,000,000 for the Segal collateral, designated in the plan "Segal matters." The company was to be given the $2,500,000 outright and then was to have in addition the first $3,000,000 which might be realized from the "Segal matters." The subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal matters." This plan of reorganization became effective. It provided in part that the subscribers to the $2,500,000 fund made such subscriptions with the understanding that if from the administration of the "Segal matters" $3,000,000 should be realized, the subscribers were to receive any excess over this amount which might be realized from the same. No restrictions or time limits were placed upon the Real Estate Trust Company in regard to its administration and final disposition of the assets included in the "Segal matters." The Real Estate Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal matters" were administered exclusively by it under the direction of George H. Earle, jr., formerly receiver and thereafter president of that company.

The following table shows the names of the directors of the Real Estate Trust Company in 1906, the amount that each subscribed and paid to the guaranty fund, and the number of shares of stock in the company held by each at that time:

Name	Subscription	No. of shares
John H. Converse	$1,005,000	134
Samuel F. Houston	755,000	512
John F. Betz	153,375	75
William A. Patton	103,000	150
R. Dale Benson	100,625	230
Bayard Henry	92,500	375
(Of this sum Bayard Henry personally contributed $42,500, $50,000 being furnished to him from other sources.)		
Edward P. Borden	77,000	45
W. W. Porter	75,000	175
Frank C. Roberts	75,000	175
S. Weir Mitchell	52,500	583
Joseph de Forest Junkin	11,000	450

* Samuel F. Houston, a director, subscribed $755,000 to the fund and when the plan became effective by the required consents of creditors, stockholders, and others, and the subscribers to this fund were called upon to make payment of their subscription, Houston found that a payment by him of the full amount of his subscription would necessitate a sacrifice of his securities and investments in the then existing market at considerable loss to him, and at his proposal his sisters, and his mother took participating interests in his subscription. Houston actually contributed $305,000 to the fund and his sister, Sallie H. Henry, contributed $200,000 to the fund.

21 Sallie H. Henry was not a director, but owned 1,071 shares of stock in the company. She made her subscription upon the understanding that no personal responsibility to her was assumed by Samuel F. Houston, but that she was to look to the so-called "Segal matters" as the source from which to realize upon her subscriptions. Throughout the transactions involved herein, Samuel F. Houston acted as her agent.

Samuel F. Houston at the time he subscribed to the guaranty fund believed that the "Segal matters" had considerable potential value which under Earle's administration could be converted into a sufficient amount of cash to repay the subscribers the amount of their subscription with interest and possibly some profit in addition. He explained the plan of reorganization to his sister and told her of his beliefs in regard to the value and possibilities of the "Segal matters."

At and before the time that the petitioners herein subscribed to the guaranty fund, George H. Earle, jr., the receiver for the Real Estate Trust Company, had had conversations with the directors in which he expressed a belief that a sufficient amount might be realized from the "Segal matters" to repay to the subscribers the amount of their subscription with interest and possibly a profit.

Segal had secured a loan of $1,250,000 from Gustave E. Kissel. As collateral for this loan, Segal gave certain bonds and stock which had been deposited with the Real Estate Trust Company as collateral security for loans made by it to Segal and which had been wrongfully withdrawn from the Real Estate Trust Company by Segal with the permission of Hipple. Included in this collateral were certain bonds and shares of stock of the Pennsylvania Sugar Refining Company and in connection with the loan it was agreed between Kissel and Segal that until the loan was repaid, Kis-
22 sel, or some one to be named by him, should have the right to select four out of seven directors of the Pennsylvania Sugar Refining Company and that the latter's refinery should not be operated.

At the time the subscriptions to the guaranty fund were made, a suit against the American Sugar Refining Company under the Sherman Anti-trust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company and the value of the "Segal matters" depended to some extent upon the successful prosecution of such a suit.

Such a suit was brought in the United States District Court for the Southern District of New York for $10,000,000 and another in the Court of Chancery in the New Jersey, on the ground that Kissel, as agent for American Sugar Refining Company, had made a contract in restraint of trade with Segal. In January, 1910, the pending litigation was compromised upon the delivery to the Real Estate Trust Company by the American Sugar Refining Company of certain bonds wrongfully withdrawn from the Real Estate Trust Company among which were bonds of the Pennsylvania Sugar Refining

Company. The Real Estate Trust Company afterwards converted the latter bonds, through a foreclosure, into 7,268 shares of stock in the reorganized company, thereafter called Pennsylvania Sugar Company. This was on or before January 22, 1912.

The petitioners were thoroughly familiar with the progress of the liquidation of the "Segal matters" under the administration of the Real Estate Trust Company. Some question arose between the parties in regard to the rights under the subscription agreement including rights to interest and on May 5, 1916, a supplemental agreement was entered into. At this time and for some time prior thereto the principal unliquidated asset of the original "Segal matters" was the 7,268 shares of stock in the Pennsylvania Sugar Company and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds.

In the latter part of 1920, the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Whereupon, the subscribers either individually or by their duly constituted representatives entered into separate agreements which as a group provided for complete liquidation of the "Segal matters" by the Real Estate Trust Company distributing one-fourth of the 7,268 shares of Pennsylvania Sugar Company stock to the subscribers to the fund in proportion to the amount of their subscription in full satisfaction of all agreements of the parties pertaining thereto. The subscribers never received any other return on their subscriptions.

Samuel F. Houston entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of Pennsylvania Sugar Company stock. He, personally, was entitled to 222 of these shares. The remaining shares he received as agent for his sisters and others who had subscribed through him. These latter shares were later distributed to them by him, 158.61 shares being delivered to Sallie H. Henry in the early part of 1921.

Bayard Henry signed an agreement with the Real Estate Trust Company and on January 21, 1921, received as his pro rata share, 37 shares of Pennsylvania Sugar Company stock.

William W. Porter signed such an agreement and on January 23, 1921, received as his pro rata share, 54 shares of Pennsylvania Sugar Company stock.

Each share of Pennsylvania Sugar Company stock received by the petitioners at the time received had a fair market value of $150.

At the end of 1920, Samuel F. Houston wrote off his books as a loss $271,700 computed by deducting the value of the stock which he received from $305,000, the amount of his subscription. In reporting income for 1920 he deducted this amount as a loss.

In reporting his income for the year 1921, William W. Porter deducted $66,900 as a loss, computed by deducting the value of the shares he received from the amount of his subscription. He later paid tax under protest on his income increased by the amount of this alleged loss. He thereafter filed a claim for refund, whereupon the commissioner advised him that the amount of the loss claimed had been allowed and enclosed a copy of a letter signed by the Solicitor of Internal Revenue, dated August 21, 1923, stating that the alleged loss constituted an allowable deduction. The commissioner refunded the difference in tax to the petitioner. Thereafter on February 3, 1925, the commissioner sent a deficiency notice to the petitioner in which he stated in part as follows:

"In a recent decision made by the Solicitor of Internal Revenue with respect to the Real Estate Trust Company transaction, it is held that no deductible loss was incurred by the directors of such company and the former ruling in your favor is revoked."

Sallie H. Henry and Bayard Henry on their 1921 returns deducted as losses the difference between the amount subscribed and the value of the shares received.

In the case of each petitioner the commissioner has disallowed the deduction for the alleged loss resulting from the subscription to the guaranty fund.

25 OPINION

MURDOCK: With the exception of William W. Porter, none of the petitioners herein have pointed to any particular section of the revenue act as authority for the deduction claimed. They all contend, however, that the transaction was entered into for profit. William W. Porter claims the deduction under section 214 (a) (5) of the revenue act of 1921. We will discuss the case as if each petitioner were claiming a loss under this section, or, in the case of Samuel F. Houston, the corresponding section of the revenue act of 1918, because we can think of no other section of these revenue acts which would give any more support to the petitioner's contentions. These sections provide for the deduction of "Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

We need not discuss at length the question of whether or not the petitioners entered into this transaction for profit, since for another reason we cannot allow the deductions which they claim.

In consideration of the money subscribed and paid to the so-called guaranty fund each subscriber thereto acquired certain rights which were thenceforth his property and which cost him the amount of his subscription. On March 1, 1913, each subscriber still had these same rights. If he disposed of them in 1920 or in 1921, then under section 202 (a) (1) of the revenue act of 1918, as interpreted by the courts and by this board, and under the express provisions of section 202 (b), the loss, if any, from the disposition of those rights, the subject

matter of the entire transaction, would be the difference between what was ultimately received for the rights and their cost, or March 1, 1913, value, whichever was lower. See the acts referred to;
26 Goodrich v. Edwards, 255 U. S. 527; Walsh v. Brewster, 255 U. S. 536; U. S. v. Flannery, 268 U. S. 98; McCaughn v. Ludington, 268 U. S. 106; Anniston City Land Co., 2 B. T. A. 526; Frank C. Stearns, 5 B. T. A. 958; and also Ayer v. Blair, 26 Fed. (2d) 547.

The subscribers to the so-called guaranty fund in accordance with their agreement paid to the Real Estate Trust Company $2,505,000 in the year 1906. This money was thenceforth the property of the Real Estate Trust Company and the subscribers to the fund were to look solely to the excess proceeds which the Real Estate Trust Company might subsequently realize on certain assets which were called "Segal matters." If and when the amount realized by the Real Estate Trust Company from the administration of these "Segal matters" amounted to $3,000,000, any additional amount which might thereafter be realized from the further administration or disposition of these assets was to belong to the subscribers to the fund. The subscribers could at no time withdraw their subscriptions but if a purchaser could have been found they could at any time have sold their rights under the subscription agreement. The Real Estate Trust Company was only required to use due diligence and reasonable judgment in the administration, disposition, and final liquidation of the "Segal matters." It began to administer these assets in 1906, and it had not completed its task at the end of 1920. We know nothing of the amount realized by the company from any of these assets prior to December 30, 1920. The record in this case gives no basis for a conclusion that during all of this time the value of the rights which subscribers to the fund acquired in 1906 remained constant. No effort has been made to show us what the March 1, 1913, value of the rights in question were or whether indeed these rights had any value on that date. Consequently, we can not do
27 otherwise than approve the determination of the Commissioner.

In addition, in the case of Sallie H. Henry, it clearly appears that her brother, Samuel F. Houston, as her agent, received her share of the Pennsylvania Sugar Company stock in the year 1920. The mere fact that he did not deliver the shares to her in person in the year 1920 would not delay the closing of the transaction for income tax purposes or entitle her to deduct any resulting loss in 1921, rather than in 1920.

The petitioner, William W. Porter, has alleged an additional error as set out in our opening statement above. He admits that the decisions of this board have been adverse to his contention but calls our attention to the case of Woodworth v. Kales, 26 Fed. (2d) 178. A careful consideration of the latter case leads us to the conclusion that the decision therein was based upon facts substantially different from those involved in the present case and that the court in deciding the Kales case indicated that it did not intend to decide such a case

as is now before us. A case more nearly in point is the Dallas Brass & Copper Co., 3 B. T. A. 856, and following that case we hold against the petitioner. See also James Couzens, 11 B. T. A. 1040, promulgated May 5, 1928, and Rosetta V. Hauss, 12 B. T. A. 755, promulgated June 22, 1928.

Judgment will be entered for the respondent.

Now, July 1, 1929, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL.] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

28 Before United States Board of Tax Appeals

Order of redetermination

Filed August 29, 1928

Pursuant to the board's findings of fact and opinion, promulgated August 28, 1928, it is ordered and decided: That, upon redetermination, there is a deficiency for the year 1920 in the amount of $191,830.53.

(Sgd.) JOHN B. MILLIKEN,
Member, United States Board of Tax Appeals.

Dated Washington, D. C.
Enter.

Now, July 1, 1929, the foregoing order of redetermination certified from the record as a true copy.

[SEAL.] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Petitioner's petition for review

Filed February 23, 1929

To the Honorable, the Members of the United States Board of Tax Appeals:

The petition of Samuel F. Houston, petitioner, for review of the final decision of the United States Board of Tax Appeals, entered August 28, 1928, in the above-entitled case, respectfully represents:

First. The petitioner is a citizen of the United States of America and resident of the city of Philadelphia, county of Philadelphia, State of Pennsylvania, within the Third Federal Judicial District.

29 Second. The nature of the controversy is the determination of a claim for deficiency in income taxes for the year 1920 in the sum of $191,830.53. The commissioner disallowed a deduction taken by

the petitioner from gross income for the year 1920 in the sum of $271,700, representing a loss incurred in a transaction involving a subscription of $305,000 to a certain "guaranty fund" entered into for profit by the petitioner in the year 1906, terminated as to the petitioner in 1920, when the petitioner received in liquidation of the said fund 222 shares of the stock of the Pennsylvania Sugar Company aggregating a value of $33,300 in lieu of cash as his share of the proceeds of the transaction.

The guaranty fund arose out of financial difficulties of the Real Estate Trust Company of Philadelphia, which closed its doors in the summer of 1906, when George H. Earle, jr., was appointed receiver.

The financial embarrassment of the trust company was due to the use of its funds by Frank K. Hipple, its president, in the financing of certain projects, promoted by Adolph Segal, and the taking of collateral of uncertain value for loans to Segal.

The receiver promulgated a plan of reorganization which included, as one of its provisions, the creation of a guaranty fund of $2,505,000, under the terms and conditions set forth in the plan, to be used by the trust company pending the liquidation of the Segal collateral, which were referred to in the said plan as "Segal matters," as protection against loss therefrom.

Samuel F. Houston, petitioner, who was one of the directors, and a stockholder, subscribed in his name to the said guaranty fund the sum of $755,000, $305,000 of the subscription being made by the said Samuel F. Houston, with his own funds and the balance for others, who shared a participating interest in the said subscription with the said Samuel F. Houston to the extent of the amounts furnished by them.

No securities, or "rights" negotiable or others, were issued to the subscribers for their payments to make up the "guaranty fund."

The plan of reorganization provided that the subscriptions were made with the understanding that if the "Segal matters" should be so administered as to realize an amount which would make the capital and apparent surplus of the trust company whole, the impairment of which was assumed to be $3,000,000, the subscribers should receive all excess over this amount.

The plan of reorganization became effective November 1, 1906, the Real Estate Trust Company resumed business, and the "Segal matters" were administered by the company under the direction of George H. Earle, jr., formerly receiver, and thereafter president of the company.

An agreement was made between the trust company and the other subscribers, dated as of May 5, 1916, which was supplemental to the original agreement under which the subscriptions were made. This agreement was based on an opinion of John G. Johnson, Esq., as to the status of the several parties to the original plan of reorganization. The petitioner was advised of this agreement when it was made.

The said supplemental agreement of 1916 provided the basis for the future payments of principal and interest to the trust company

and the subscribers. The agreement settled a controversy concerning priority of interest payments which were established as follows: Out of any income or dividends received thereafter by the trust company in each year from such assets of the Segal matters as were not already disposed of, five per cent should be first paid to the
31 trust company upon the balance of the former assumed capital and surplus of $3,000,000 remaining unliquidated, and three per cent should next be paid to the subscribers upon any balance of the fund of $2,505,000 remaining unreturned, and that further income in each year should be applied first to the liquidation of any balance of the trust company's $3,000,000 and after complete liquidation of said amount, the remainder should be applied to the liquidation of the $2,505,000 due to the subscribers to the guaranty fund.

In the year 1920 the parties concerned agreed to terminate the agreement and dispose of the assets on hand. The parties entered into an agreement on December 30, 1920, for the complete liquidation of the Segal matters by distribution in kind.

The petitioner received in the year 1920, 222 shares of the common stock of the Pennsylvania Sugar Company as his proportionate share of the total number of shares received by him from the trust company.

The value for said stock was $150 a share, and the petitioner claimed as a loss in the year 1920 the difference between his original subscription of $305,000 and the aggregate value of his shares computed on a basis of $150 a share, which was the amount of $271,700. This sum was the loss charged off on his books for the calendar year 1920 by the petitioner.

This loss was allowed by the field agent but disallowed by the commissioner in his letter of June 2, 1924, for the reason therein given.

"In regard to the disallowance of $271,700 you are advised that under the provisions of revenue act of 1918, no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of and the evidence is to the effect that the stock was still in your possession at the close of the year 1920."

32 This rejection was affirmed by the commissioner December 18, 1925.

The decision of the United States Board of Tax Appeals filed August 28, 1928, affirmed the decision of the Commissioner of Internal Revenue, but for a different reason, holding that—

"No effort has been made to show us what the March 1, 1913, value of the rights in question were or whether indeed these rights had any value on that date. Consequently, we can not do otherwise than approve the determination of the commissioner."

Third. That review of said final decision is sought in the United States Circuit Court of Appeals for the Third Circuit.

Fourth. That your petitioner makes the following assignments of error:

1. The learned board erred in finding the following:

"In consideration of the money subscribed and paid to the so-called guaranty fund each subscriber thereto acquired certain rights which were thenceforth his property and which cost him the amount of his subscription. On March 1, 1913, each subscriber still had these same rights. If he disposed of them in 1920 or in 1921, then under section 202 (a) (1) of the revenue act of 1918, as interpreted by the courts and by this board, and under the express provisions of section 202 (b), the loss, if any, from the disposition of those rights, the subject matter of the entire transaction, would be the difference between what was ultimately received for the rights and their cost, or March 1, 1913, value, whichever was lower."

2. The learned board erred in finding in relation to the guaranty fund that—

33 "This money was thenceforth the property of the Real Estate Trust Company and the subscribers to the fund were to look solely to the excess proceeds which the Real Estate Trust Company might subsequently realize on certain assets which were called 'Segal matters.'"

3. The learned board erred in finding that—

"The subscribers could at no time withdraw their subscriptions, but if a purchaser could have been found they could at any time have sold their rights under the subscription agreement."

4. The learned board erred in finding as a legal conclusion that—

"The record in this case gives no basis for a conclusion that during all of this time the value of the rights which subscribers to the fund acquired in 1906, remained constant. No effort has been made to show us what the March 1, 1913, value of the rights in question were or whether indeed these rights had any value on that date. Consequently, we can not do otherwise than approve the determination of the commissioner."

5. The learned board erred in failing to find that the loss claimed by the petitioner was a guarantor's loss which was not ascertainable until the liquidation value of the obligations guaranteed was conclusively established when the transaction was finally closed as to the guarantor.

6. The learned board erred in refusing to find that the deduction claimed by the petitioner was lawful to the extent of the difference between the amount of the petitioner's original participation in the guaranty fund and the amount realized by the petitioner when the transaction was closed as to him in 1920.

7. That the learned board erred in refusing to find that the

34 transaction which was the basis of the deduction claimed was one in relation to which the rule requiring the ascertainment of values as of March 1, 1913, had no application.

8. The learned board erred in refusing to find that the burden was upon the Commissioner of Internal Revenue, respondent, to establish the value as of March 1, 1913, of the participating interest secured by the petitioner in the guaranty fund in 1906, if such

valuation as of March 1, 1913, was relevant, and that the failure of the commissioner to sustain the burden of proof did not impose this burden of proof upon the petitioner.

9. The learned board erred in refusing to conclude as a matter of law that—

"The petitioner is entitled under section 214 of the revenue act of 1918 to the deduction from gross income for the year 1920 for the loss resulting from his participation in the guaranty fund in 1906."

10. The learned board erred in failing to find that the Commissioner of Internal Revenue erred in disallowing the deduction claimed by the petitioner for the year 1920 and in refusing to disapprove this determination.

11. The learned board erred in entering judgment for the respondent, the Commissioner of Internal Revenue.

Wherefore, your petitioner prays that the United States Circuit Court of Appeals for the Third Circuit may review the action of the Board of Tax Appeals in this cause, reverse the decision of the board and direct the entry of judgment by said board in favor of the petitioner, determining that the deduction claimed for the year
35 1920 be allowed, or for such other and further relief as may appear to the court proper in the premises.

WM. CLARKE MASON,
Attorney for Petitioner.

MORGAN, LEWIS & BOCKIUS,
Of Counsel.

[*Duly sworn to by Samuel F. Houston. Jurat omitted in printing.*]

Service of the within petition for review and notice of the filing of the original petition is hereby accepted this day of February, A. D. 1929.

(Sgd.) C. M. CHAREST,
General Counsel for the Commissioner of Internal Revenue, Respondent.

Now, July 1, 1929, the foregoing petition for review certified from the record as a true copy.

[SEAL.] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

36 Before United States Board of Tax Appeals

SAMUEL F. HOUSTON, PETITIONER
v.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT
} Docket No. 11832

Statement of evidence

Filed June 27, 1929

The evidence in this appeal consists of a stipulation of facts which was entered into by the attorneys for both parties, and also certain

testimony which was taken at the time of the hearing before the board.

Stipulation as to facts

The taxpayer is an individual residing at Druim Moir, Chestnut Hill, Philadelphia, Pennsylvania, and the taxes in controversy are income taxes and surtaxes for the calendar year 1920 in the sum of $191,830.53.

The Real Estate Trust Company of Philadelphia closed its doors in the year 1906, and George H. Earle, jr., was appointed receiver by the Court of Common Pleas No. 4, of Philadelphia County, Pennsylvania, on August 28, 1906.

The financial embarrassment of the Real Estate Trust Company was due to the use of its funds by Frank K. Hipple, president, in the financing of certain projects promoted by Adolph Segal, and the taking of collateral for loans to Segal of a character which did not permit of ready liquidation, but were securities of uncertain value.

37 The receiver promulgated a plan of reorganization which included, as one of its provisions, the creation of a fund of $2,500,000 by the directors of the company to guarantee a value for the Segal collateral, designated in the plan "Segal matters," upon the terms and conditions set forth in this plan.

Samuel F. Houston, the taxpayer, who was one of the directors, subscribed in cash to the so-called guarantee fund the sum of $755,000. When the plan became effective by the required consents of creditors, stockholders, and others, and the subscribers to this fund were called upon to make payment of the subscriptions, the taxpayer found that a payment by him of the full amount of his subscription would necessitate the sacrifice of securities and investments in the then existing market to the point of considerable loss to him, and he made a proposal to his sisters, Sallie H. Henry and Gertrude Houston Woodward, that they take a participating interest in his subscription to the extent of $200,000 and $150,000 respectively.

The other $100,000 is subscribed by a taxpayer who is not included here in any claim for a refund. His mother was one of those who also contributed.

The plan of reorganization, in so far as it related to the "Segal matters" provided that "The contributors to the $2,500,000 fund made such contribution with the understanding that if these Segal matters shall be so administered as to realize an amount which would make the capital and apparent surplus whole, they should receive from the company any excess over this amount."

The plan of reorganization became effective, the Real Estate Trust Company resumed business November 1, 1906, and the Segal mat-

ters were administered by the company under the direction of George H. Earle, jr., formerly the receiver, and thereafter the president of that company. The taxpayer was advised from time to time of the progress of the administration of the Segal matters and was familiar with and consented to a certain agreement entered into by the Real Estate Trust Company and committee of the contributing directors of which the taxpayer was one as of May 5, 1916.

38

This agreement was supplemental to the original agreement under which the subscriptions were made and resulted from the opinion of John G. Johnson, Esq., of July 15, 1915, as to the rights of the several parties to the original plan of reorganization.

The liquidation of the Segal matters progressed under the administration of the Real Estate Trust Company until the year 1920, when the parties concerned, after full investigation, were of opinion that the liquidation agreement had rendered its maximum of service, and that the values shown in the latter part of 1920 for the remaining Segal assets were the maximum which such assets would have for a substantial period of time to come.

The parties, by their duly constituted representatives, or in person, thereupon entered into an agreement as of December 30, 1920, whereby it was provided for a complete liquidation of the Segal matters by a distribution in kind.

The taxpayer received, in accordance with the terms of the said agreement, 548.734 shares of the common stock of the Pennsylvania Sugar Company in full and complete satisfaction and discharge of his interest in the Segal matters.

That of the said 548.734 shares of the common stock of the Pennsylvania Sugar Company received by the taxpayer, 222 shares thereof, represented his proportion, and the remaining shares, by reason of the agreement between himself and his sisters, were received by him on their account and were accounted for by him to them in satisfaction of their subscriptions to the fund.

39

It is agreed that the market value of the common stock of the Pennsylvania Sugar Company as of December, 1920, and the early part of 1921 was the sum of $150 per share. That covers all of the cases. And that the loss claimed by the taxpayer Samuel F. Houston, ascertained in 1920, was written off on the basis of 222 shares at $150 per share, making $33,300, and the difference between that and $305,000 is $271,700.

The total subscriptions to the shares, the names of the directors of the Real Estate Trust Company in 1906, and the amount of the subscription of each and the number of shares held by them at the time they became subscribers to the guarantee fund are as follows:

Name	Subscription	Number of shares
John H. Converse	$1,005,000	155
Samuel F. Houston	775,000	513
(Of this $755,000 only $305,000 was contributed by Samuel F. Houston personally. The balance was contributed by his sisters, Sallie H. Henry and Gertrude H. Woodward and by his mother, in the respective sums of $200,000, $150,000, and $100,000.)		
John F. Betz	153,375	75
William A. Patton	103,000	150
R. Dale Benson	100,625	220
Bayard Henry	92,500	375
(Of this sum Bayard Henry personally contributed $42,500, $50,000 being furnished to him from other sources, his claim however being limited to the difference between his personal contributions of $42,500 and the stock which he received.)		
Edward P. Borden	77,000	45
W. W. Porter	75,000	175
Frank C. Roberts	75,000	175
S. Weir Mitchell	52,500	503
Joseph deForest Junkin	11,000	450

EXHIBITS

It is stipulated that the following exhibits, Nos. 1, 2, 3, 4, 5, 6, and 9, which were received in evidence without objection, may be included in the record for appeal:

Petitioner's Exhibit 1

PLAN FOR REORGANIZATION OF THE REAL ESTATE TRUST COMPANY OF PHILADELPHIA

To the creditors and stockholders of the Real Estate Trust Company of Philadelphia:

It is so natural to follow the forms to which one is accustomed that I have again and again started to draw the regulation financial plan that absorbs as much power and gives as little information as possible, and have as often given up in disgust at the total uncongeniality and inadequacy of any such method in the present emergency.

41 If I am now, at last, making progress, it is because I have determined, disregarding precedent, to follow my natural bent and have, as Mr. Roosevelt would say, "A heart to heart talk" with you.

Indeed, nothing else will do. The situation is so complex; the matter is so justly for your determination; on each question there are so many pros and cons that you should, and in all probability will in any event, require full explanation before deciding. So let us begin where we would in any event end.

I am, therefore, now, not only going to give you my recommendations and ask your assent; but I shall as well lay the situation, as I see it, before you; and so try to point out not merely what I think, but just why I believe the adoption of my suggestions is absolutely essential to your welfare.

I desire your first consideration to a matter that gives me great concern. It is obvious that it would be desirable, could I take plenty

of time, to work out the value of all assets and definitely ascertain the exact extent of liabilities, including surety and trusteeships, as well also as the possible total of your resources. In an ordinary case, prudence would inevitably demand this; but there are emergencies, that make it imperative that fair business risks be courageously taken, and where the ordinary precautions of commonplace affairs would be supine folly.

The first question, therefore, that I ask myself, and now ask you, is: Is this the ordinary or the extraordinary occasion? Is it a case where something must be lost by delay and only may be lost by prompt action?

I see no absolutely certain asset that action will deprive you of. I do see, however, how desirable it would be absolutely to know the exact extent and value of our assets and to positively limit our liabilities.

Strenuous efforts are already being made to escape liability
42 by debtors to the company as well as to foist liability upon the company. My confidence in the astuteness and virtue of our courts convinces me they will not succeed. As this is important, I want to illustrate just what I mean. I called a note—I don't remember whose—but for considerable amount. The alleged maker discovered that he had never signed it nor gotten a dollar of the money. But when I told him that the collateral exceeded the debt by thousands of dollars, the signature so rapidly improved that I am confident it would have become genuine had I but given due time. Apart from this class of cases I should call your attention to another matter. A lawyer called and said that his clients had loaned Segal too much money on his allegation of the merits of a particular enterprise and that as part of the funds might have been paid on indebtedness undoubtedly due to you he would look to us to recoup his possible loss. My counsel agree with me in thinking that fantastic, but so it goes. These are risks that you must take, but you can reassure yourself by remembering that a president's powers are limited, and that the courts are composed of honorable men, astute to limit, not to encourage, the frauds of trustees. Prudent persons do not deal with officers, in matters of magnitude, without certified board action, and both boards and the public have a right to rely on this, and those alleging such *por*cedure are viewed with proper suspicion. But I am determined, so far as in me lies, to thwart any such shabby attempts. A taste for blood once acquired is not easily assuaged, and dishonesty did not die with Hipple. I think it, therefore, imperative that I should be empowered, should counsel deem such claims dangerous, to give you interim protection until the civil or criminal courts can finally dispose of them. I, therefore, ask to be empowered to hold any claim of yours, or any contribution that I may receive in your
relief, in such trust as counsel may devise, should they or I
43 deem it necessary to protect it and you against this predatory class. I hope not to use it or need it, but I would fail in duty to you did I not take this precaution.

In addition, that our trust business may be retained and the courts justified in not disturbing it, I have taken such contributions as I have pledged me upon the express term and condition that until the plan is by me declared operative, they shall be held as a guarantee of the safety of the estates that we hold in trust.

Should I not have these powers, you might either lose the benefit of the trust business, or I might find that I had placed the most meritorious and worthy class of creditors, at a disadvantage in relation to those who, whether being already of those who have precipitated your troubles or not, will stop at nothing to increase them. In this respect I ask the widest discretion to so handle my trust, or modify the plan, as to give you the fullest protection that I am able. On the whole were the matter my own. I would chance these risks, provided there were any really compensatory considerations for now so doing.

Let us, therefore, consider what benefits may accrue to you from immediate reorganization.

In the first place, by delay we, of course, lose our trust business and destroy our good will. They must inevitably be gone forever. Now what are they worth and what could they have been made worth with proper management?

If I be correctly informed, before Mr. Hipple's death, your stock sold for say, three hundred and thirty dollars a share. I understand your surplus never exceeded one hundred per cent. If so, your good will was valued, not by mere theorists, but by careful investors on the market, at one hundred and thirty dollars a share; and, as your capital was one million five hundred thousand, 44 the good will that some advise you to ruthlessly destroy was alone worth about two millions of dollars! and that too (so great is the value of your position), with a president so using your funds as to make it seem strange that you had any business at all; for as he gave Segal so much, there was little left to satisfy the reasonable demands of his patrons.

You know that there are but four corners at Broad and Chestnut Streets, and I would like you to inquire what the stock of the companies that own the other corners and are well managed brings, and I think you will fortify your conviction.

Then we have to consider your building itself. I need not tell you that others have already realized its possibilities, if you do not. Nor that whatever it is worth today it will almost certainly advance largely in value if you keep it—and that gain shall be yours, not outsiders' if I can but have my way!

But let us ignore this as speculative, and still see what further can be accomplished by prompt action.

With men above a certain calibre, all experience has taught me that more can be done by an appeal to duty and honor than by threat or coercion; and so I have thought it my duty to proceed in the way that I am convinced will bring you the best results, whether it brings me criticism or praise.

As was my duty, I have carefully looked into this question of liability—and also the ability of the directors to pay, if they be liable. And I feel bound to say to you that I would much prefer the receipt of the ready cash that their sense of honor, and the feeling that, after all, you trusted them, prompts them to give than the possible results of any protracted litigation. It may be invidious to use names, but you already know that many of the board have been severely hit by this failure; some even ruined, for their fault was trusting too much.

Others have also been affected by still other disasters and
45 troubles. Still another has his inheritance under a strict trust; and another has long preferred using his income in works of religion and charity to the accumulation of wealth. These facts must be weighed by any sane trustee, even if we have a perfectly clear claim. Again, all experience has demonstrated that the enforcement of such claims always is the cause of protracted and expensive litigation rarely profitable to any one but the members of my beloved profession. But it is my duty also in asking you to choose between litigation and the receipt in lieu thereof of real money and securities, to call your attention to the viewpoint of courts of justice when considering such claims. For it is as unfair to you to tell you that you are certain to recover, as it is to say that you have no chance of so doing.

It is not necessary to trouble you with many cases, but each one of you, whether layman or lawyer, should carefully read the decision in Swentzel vs. Bank, 147 Pa. 141. I do not say that the case can not be distinguished from ours, in fact I shall ask counsel to distinguish it, if possible; but I think you will see many points of resemblance.

Now, apart from the fact that the ultimate decision went against the creditors, I want you to note that though the bank failed in 1884, the final decision was not reached until 1892. I admit that that does not invite me.

I do not wish to detain you with quoting at large. But one paragraph of the opinion may well be borne in mind. The court says: "One must be very careful in administering the law of joint stock companies, not to press so hard on honest directors as to make them liable for their constructive defaults, the only effect of which would be to deter all men of any property, and perhaps all men who have any character to lose, from becoming directors of companies at all."

For myself, I think it just possible that able judges, deter-
46 mining after careful consideration and without excitement, may at times be right and know what is best for us. I am not at all sure that, had the board been composed of men without character or reputation, they would have managed the company any better; and I am quite sure that they would not have been willing or able, for their honor's sake, to contribute two million five hundred thousand dollars, as they are prepared to do in cash and securities if this plan is put into force in your relief, and so as to save the institution with which their names were connected.

I hope you understand that, should I follow my own selfish interests, I would litigate and liquidate, would take no personal risks, and safely collect the compensation, which should be large, but I hope you also know that in that case I would be a worse enemy of you who trust me than even Hipple; for by that course, you must see that I might destroy more value that is easily possible, than has been taken! I can not be too emphatic. It will be positively criminal not to get rid of me! Before taking my advice, it is your duty to yourselves to ask, "What are his interests"? and before taking any one's else, I beg of you to ask the same question. Not that I nor your other advisor may be dishonest, but that interest unconsciously affects the judgment of us all.

Cudgel my brain as I will, I can not remove one thought from my mind, and that is, that whatever is left, be our calculations too high or too low, the real question for you to decide is, whether by forcing me to destroy possibly five millions of your property you are adopting the best method of compensating yourself for the loss of the other five millions that have been stolen. I again beg you not to force me into so uncongenial a task. Indeed, I can not bring myself to believe that you will. It all seems so simple to me. When
we were children, I remember my surprise when I would ask
47 my elders, "What is better than one piece of pie," with
tremendous emphasis on the "one" that they so invariably answered "two" for, strangely, that was the right answer then, and it is no less the right answer now. I know just how badly you have been treated; I know that, perhaps, your digestion is so disordered, for the moment, that, contrary, to the teachings of our faith, you might think vengeance would taste sweeter. But it never does, as it is always as bitter to those that inflict it as to those who receive; and I am determined that if in the future, surrounded by a more healthy atmosphere, and with a more normal appetite, you should see someone eating all he pleases on your corner, whilst you stand hungry, you shall never point your finger at me and say that it was my fault. If you have gotten nothing else out of this situation, I am quite as conscious as you are that you are now receiving an unusual financial document, so I feel an explanation is due you.

It is a relief at all times to say what one feels, particularly when a little overworked and a good deal overwrought; but beyond and above that, ever since this emergency enlightened my eyes, I have felt that I owed the people of our good city an apology.

When Singerly's failure spread devastation broadcast, and I thought I saw, as I think I now see, the one possible chance of full relief—a chance to make millions for the sufferers or for myself, for I could have done either—Mr. Cook and myself elected, as, of course, was our plain duty, to make this profit for the creditors. And when we did make it, after a most trying experience, it was, of course, much that we knew we had done our duty; it was much that such men as the judges, Comptrollers Dawes and Ridgeley, and Theodore Wright, understood; but I must confess that until these

48 last few days there was a sense of disappointment that even those who had benefited by our efforts and sacrifices seemed perfectly unconscious of them. Of course, I was all the while conscious that, after all, it was but a matter of dollars and cents, and did not too much magnify it. But when this trouble arose, and for the first time I realized that everybody had all the while not only noted and appreciated what little we had done, but had a thousand times magnified its importance, I had a feeling of guilt that I can alone appease by working for and talking to you just as I now am. I say this not only because it brings me greater content, but because I think it wholesome that we should all understand that such services as we may render our fellows do not really go unnoted and unappreciated, however much it may so appear.

If, then, you should concur with me that we would better take our chances and save these assets, we must come to the details of our program.

It is my hope that the time may come when you will see that it was to your best interest to have received as much, instead of as little, preferred stock as possible; but I am perfectly conscious that to many of you the loss of all your ready money must have been a great hardship.

It might be better to keep it all in the treasury, but I have concluded to recommend the use of enough of the funds contributed to give each depositor a full third of his deposit in ready cash. I doubt not that you will see the wisdom of still keeping what you do not need, with what will then be your own company, without argument from me.

In the second place, I would issue a stock to be preferred as to both dividends and principal, dollar for dollar, for the balance of such claim or claims as I might not determine it would be wiser to liquidate in cash. The preference as to dividends to be limited to six per cent, but such stock to share equally in any percentage
49 with the common stock, after the common has also received six per cent, and to be redeemed, but either in common stock or cash as the holder may elect, as soon as all stock shall have received a dividend at the rate of eight per cent.

I am informed, although I have had no time for personal verification, that the good assets remaining will certainly put dollar for dollar back of this stock. The present stock will then not be wiped out, but remain as a common stock, having back of it many of the items of which I have been treating, as well as what are known as the "Segal matters," whether in his name or not. Of course, if those items should ever work out sufficient funds to restore the present supposed capital and surplus, any overplus from them would properly be returned to those who had contributed the funds to make them good; but it is not proposed to make the contributors any other return for their contributions than this, which would obviously belong to them in that happy event.

Should this plan be adopted, it would remove the troublesome question of possible double liability upon the common stock and would save every one from the uncertainties and endless delay and bitterness of protracted litigation. Directors, stockholders, and depositors could, and I believe would, join hands in building this company up to the commanding position that it should occupy. It would have ample capital, absolutely the best situation in Philadelphia, a flourishing trust business, and reasonable good will. There could be no safer place to keep money or place trusts; as, after this experience, one may be certain that care enough will be exercised in this institution at least. On its face, I can scarce think of a financial enterprise more inviting. What trust company is there whose stock was originally issued at par on so favorable terms as this preferred stock will be? I certainly know of none. Already people are asking me if they can procure any of it, and I wish to reserve the privilege to purchase some for myself and my companies should it be on the market. I fully appreciate all the difficulties and uncertainties, but if there was ever a chance for the creditors of an institution by a little patience to get out, not only without loss, but with possible profit, in my judgment this is the time. It is obvious that however great or small the assets, it is just as imperative that we should also save those of which I have been treating to this end.

It is my further suggestion that should these recommendations become operative the then body of stockholders should meet and select their own president and directors, retaining only those whom they think may benefit the enterprise.

You must understand, however, how imperative is prompt action, and should you concur with me, not merely return the enclosed assent as speedily as possible, but see to it that no fellow stockholder or depositor should jeopard both his and your own interest by neglect to act with equal promptitude. I feel, now, that I have fully cleared my conscience and discharged my duty to you. I hope and believe that I have pointed out the way to safety; but it is your sole right to say whether it shall be followed or not.

If you want me to liquidate as receiver, I want you to believe that I shall do my best to realize as much from what will then be a wreck as possible. And I shall, upon receiving John G. Johnson's advice, of its wisdom, institute suit against the directors, and leave its prosecution in his able hands. But, if the receivership be continued, against my advice, I do not want you to charge me with the results, for I am as certain as I live that, do the best I can, the outcome will not and can not be made to satisfy any one of you.

I know that I can but lead you to the water, but I beg of you to remember that if you refuse to drink and are athirst, that I did lead you to the water.

Upon this corner must be reared one of the great financial institutions of the future. It may come soon or late, but it must come. The sole question for you to decide is whether that institution shall

be yours, or that of others who are already earnestly seeking it. And that question you must now answer.

GEORGE H. EARLE, Jr. (Signed.)

September 12th, 1906.

Petitioner's Exhibit 2

PLAN FOR REORGANIZATION OF THE REAL ESTATE TRUST COMPANY OF PHILADELPHIA, FORMULATED BY GEORGE H. EARLE, JR., AS OF SEPTEMBER 12TH, 1906, AS AMENDED AND PERFECTED UNDER SUGGESTIONS OF COUNSEL.

1. The business of the company shall be resumed as soon as the requisite authorization of the necessary increase of its capital stock shall have been voted by its stockholders, or unanimous consent obtained therefor, and the existing deposits shall have been dealt with in the manner immediately hereinafter stated.

2. Upon its resumption of business, the company shall charge, as though the same had been withdrawn by check against the account of each assenting depositor, as the same stood at the closing of the institution on August 28th, 1906, 66⅔ per centum thereof, leaving a balance due to each assenting depositor, of 33⅓ per cent, of said amount as the same so stood due at said closing.

In consideration of such charge against such depositor's account, he shall be entitled to receive an equal amount in preferred stock of the said company, to be delivered to him as soon as the certificates can be prepared. In advance of such actual issuance of stock, a temporary certificate shall be delivered to Mr. Earle, which he is authorized to surrender upon receipt of the final certificate. Mr. Earle's receipt for such temporary certificate shall operate with like force and effect as if such assenting depositor had been actually paid, on account of his deposit, in cash, the sum of 66⅔ per cent of the amount thereof.

3. The preferred stock so to be issued to each assenting depositor shall be preferred as to principal in any distribution or liquidation of the principal assets of the company. It shall also, to the extent of six per centum per annum, be preferred as to dividends. No dividends shall be declared upon the common stock so long as the holder of the preferred shares shall have failed to have had declared, in his favor, dividends at the rate of six per centum per annum. After the preferred shares shall have had dividends declared in their favor, to the extent of six per centum per annum, the common stock shall be entitled to dividends until the amount declared thereon shall be equal to the percentage (six per centum per annum) which shall have been declared upon the preferred shares. Thereafter in any further declarations of dividends, the preferred and common stock shall share alike, pro rata.

The preferred stock having been issued to finance the company, with an understanding that it should be redeemable and should be

retired and cancelled, to a certain extent, under certain circumstances, such preferred stock shall be redeemable at any time
53 after, in any one year, dividends upon both preferred and common stock, at the rate of eight per centum per annum, shall have been received by the holders of both preferred and common shares. The redemption shall be, as the holders shall elect, either in common stock at par or in cash.

The company reserves the right, with the assent of the holders of preferred shares, to purchase such shares at any time hereafter at such price as, legally, can be paid by it.

4. At the time of the failure of the company it held what are known as the "Segal matters" which designation included not merely transactions in the name of Adolph Segal; but also other transactions brought about by him or in which he, in some way, directly or indirectly, was interested or had been concerned. The aggregate of these matters was about $5,300,000. Had they been worth their face value, the corporation would not have been insolvent. A schedule of such items to be filed with the commissioner of banking to prevent future controversy.

The contributors to the $2,500,000 fund made such contribution with the understanding that if these "Segal matters" shall be so administered as to realize an amount which would make the capital and apparent surplus whole, they should receive from the company any excess over said amount.

If these matters, when administered, shall realize, in cash or its equivalent, to the company an amount in excess of $3,000,000 (representing the supposed former capital and surplus) any such excess, so realized, as realized, shall, from time to time, be paid to said contributors in proportion to the amounts by them respectively contributed.

Until the amount of their contributions, with interest, shall
54 have been reimbursed, said "Segal matters" shall constitute part of the assets or capital of the company, subject only to this provision of conditional payment of excess to said contributors.

5. The issuance of preferred stock as proposed and the contribution of $2,500,000 have been made with the intention of protecting the interests of all existing bona fide creditors, and of securing equality of distribution amongst them as far as possible. The plan has been accepted and is intended to be carried out without benefiting in any way persons who may hereafter present claims, not now known to the directors, concealed from them for the present, improperly.

It is intended, therefore, as far as possible to protect those who have approved the plan and have made their contributions, from unforeseen and suspicious claims.

To this end and for this purpose only, the contributors of the $2,500,000 fund have assigned to George H. Earle, jr., as trustee for the holders of preferred stock, a right to demand from the company a return of their contribution with interest, in case of the pres-

entation of claims at present unknown to the board of directors, which, by their vote hereafter, they shall declare suspicious.

If, at any time hereafter, the directors of the company shall deem it to the interest of the company, because of the presentation of such unforeseen or suspicious claims, to confess a judgment in favor of said Earle, as trustee, for the amount of such contributions, viz, $2,500,000 with interest, they may do so, and Mr. Earle shall be entitled, as trustee for the holders of the preferred stock, to make such use of said judgment as in his discretion shall be deemed best to protect them against ill results from such claims. Such use, however, shall not in any way prejudice the rights of creditors of the trust company whose indebtedness shall hereafter be incurred. The rights reserved above in favor of the holders of the preferred stock shall be subject to the duty of protection in the first instance of any such subsequent creditors.

In case of vacancy in the trusteeship by the death or resignation of Mr. Earle or any successor, the board of directors shall be authorized from time to time to elect a successor.

Whenever, hereafter, the trustee shall deem all danger of such unforeseen claims to be at an end, he shall be authorized to enter into such agreement with the company as shall terminate any further liability, even conditional, for said advance. The utmost latitude of discretion may be exercised by the trustee under this clause, and his use of the power conferred upon him shall be solely to the extent and for the purpose prescribed, and without liability in case of error of judgment. As heretofore stated in the plan, the contribution of $2,500,000 by the directors of the company, shall be taken as having been made by way of indemnity against and release of all claims by the company, for the benefit of such assenting stockholders, or creditors, or by such assenting stockholder or creditor.

6. It shall be the duty of the assenting holders of the existing certificates of common stock of the company, without delay, to present the same at the office of the company in order that said certificates may be properly stamped as subject and entitled to the conditions and benefits of this plan of reorganization.

7. All the provisions of the original plan, permitting payments in cash, shall remain unimpaired. The company shall have power, if it shall so desire, to issue and dispose of preferred stock, at not less than par, in the case of deposits not covered by assents, to the extent of two-thirds of such deposits, in order that if it shall deem it necessary, it may thus raise funds necessary to meet the claims of such depositors. Nothing herein contained is intended to prevent such purchases by the company as may be legal, from assenting depositors, to whom preferred stock shall be issued, if it shall so desire.

GEORGE H. EARLE, Jr. (Signed.)

October 24, 1906.

I approve of this as the final draft of the plan and declare it operative. The directors, contributors to the fund, having first authorized me to do so, and apply their contributions, upon the assents from stockholders and depositors already received.

GEORGE H. EARLE, Jr.,
October 24, 1906.

Authorized as above:

SAMUEL FREDERICK HOUSTON.
JOHN H. CONVERSE.
S. WEIR MITCHELL.
E. P. BORDEN.
FRANK C. ROBERTS.
WM. W. PORTER.
R. DALE BENSON.
BAYARD HENRY.
WM. A. PATTON.
JOHN F. BETZ.
JOSEPH F. JUNKIN.

57 *Petitioner's Exhibit 3*

OPINION

As part of the plan for the reorganization of the Real Estate Trust Company of Philadelphia, formulated with extraordinary ability by Mr. Earle, certain directors contributed a fund, amounting to $2,500,000, to the company.

The plan as revised and ultimately adopted, differed in respect to this contribution somewhat in phraseology, though but little in substance from that embodied in Mr. Earle's original phraseology.

Mr. Earle, after referring to what he called the "Segal matters," said:

"Of course, if those items should ever work out sufficient funds to restore the present supposed capital and surplus, any overplus thereafter would properly be returned to those who had contributed the fund to make them good; but it is not proposed to make the contributors any other return for their contributions than this, which would obviously belong to them in that happy event."

The ultimately adopted plan, which alone must be interpreted, dealt thus with these contributions:

"4. At the time of the failure of the company it held what was known as the 'Segal matters,' which designation included not merely transactions in the name of Adolph Segal; but also other transactions brought about by him or in which he, in some way, directly or indirectly, was interested or had been concerned. The aggregate of these matters was about $5,300,000. Had they been worth their face value, the corporation would not have been insolvent. A schedule of such items is to be filed with the commissioner of banking to prevent future controversy. The contributors to the $2,500,000 fund made such contribution with the understanding that if these 'Segal matters' shall be so administered as to realize an
58 amount which would make the capital and apparent surplus whole, they should receive from the company any excess over said amount. If these matters when administered, shall realize in

cash or its equivalent, to the company an amount in excess of $3,000,000 (representing the supposed former capital) any such excess so realized, as realized, shall, from time to time, be paid to said contributors in proportion to the amounts by them respectively contributed. Until the amount of their contributions, with interest, shall have been reimbursed, said 'Segal matters' shall constitute part of the assets or capital of the company, subject only to this provision of conditional payment of excess to said contributors."

My opinion has been asked with reference to the interpretation of this part of the reorganization plan. The nature of the question will appear by my answer:

The answer, I regret to say, is one concerning which there may be a decided difference of judgment which is to my discredit, as the phraseology of the revised plan was mine and it was my duty to use such phraseology as would not permit of any doubt as to the meaning of the same thereafter arising.

What I had in my mind when I wrote the words which I have quoted is not now in my memory with any certainty, which is all the better, because it is not what I thought, but what is properly deductable from what I wrote and was accepted.

In like manner I could not be influenced by what was in Mr. Earle's mind at the time: (1) Because, again, the written language must be construed and not the unwritten thought, and (2) because if there is any difference in phraseology, it is the later and not the earlier which must be interpreted.

In point of fact, however, the conclusion which I have reached as to the proper interpretation of the revised plan would be
59 reached by me with equal confidence if the original had been incorporated ipsis verbis in the revised plan.

Of course, the "Segal assets" were assets and capital of the company. The latter never parted or agreed to part with title thereto.

I am not helped, therefore, in my interpretation by the fact that it is stated that these matters "shall constitute part of the assets or capital of the company."

The question is not whether they were part of the company's assets; but what rights existed and exist in the company and in the contributors with reference to the same.

This question is expressed in the concluding line of the sentence, in which it is said that these assets of the company are "subject only to this provision of conditional payment of excess to said contributors."

It is the conditional provision of excess that we are to determine. The last paragraph throws us back upon the preceding one and compels us to reach our conclusion as to the meaning by their consideration.

These "Segal matters" were assets that had aggregate value considerable in amount. In fact they were valued at, or nearly at $775,000. They were not in such shape, however, in which either company or contributors desired their value as between themselves to be de-

termined. There was no market in which they could probably be reasonably well disposed of. They required to be "administered."

The company, asserting its right to these assets as its property, agreed to administer them in a way which might result in benefit to the contributors. This administration became a duty. It did not limit itself in the manner of this administration. The discretion as to when and how these assets should be administered was reposed in it alone. The contributors were entitled to nothing other
60 than an honest administration by the company, exercising ordinary prudence and intelligence.

Had the company years ago determined that it was proper to sell, say, the Pennsylvania Sugar Refining Company's stock and had it sold the same, the amount of the proceeds thus realized alone could have been claimed in an accounting by the contributors. This would have been the case even though, at a later time, these shares could have been sold for double or treble the value thus obtained.

Of course, the company could not make a pretense of a sale; parting, apparently, with the title and reserving the benefit for itself. An honest sale, however, through any third person of any assets, determined the amount to be credited when the general account should be taken.

An administration of these assets involved every method of obtaining value therefrom. It involved not merely the obtaining proceeds of sale; but also the obtaining of income and dividends therefrom.

However cash or its equivalent should be realized from these "Segal matters," the amount realized was an item to be considered in determining whether there was or was not an "excess" within the meaning of the contract.

Concerning these assets, the company agreed that there should be a segregation, at least so far as concerned the account of what should be realized therefrom. Without any limitation as to how anything should be realized therefrom, whether by way of dividends, income or sale, the company agreed that what was realized should be accounted for.

As each of the original items of the "Segal matters" was converted into cash or its equivalent, it was the duty of the company to credit to the account the amount of such realization, having previously credited the account with any dividends or income collected from such asset before conversion.

61 Had none been thus collected, the amount to be credited would be the proceeds of sale. Had some been collected by way of income or dividends, the amount to be credited would be the amount received at the sale, plus such income collected in excess.

In my opinion the company immediately upon the realization of the cash or its equivalent for one of the "Segal matters," was entitled to use the proceeds free of all obligations. It might invest or not invest. In case it should invest, the contributors, having been cred-

ited with the proceeds, had no further right to the income thereafter derived therefrom.

If the amounts thus from time to time credited became equal to the sum of $3,000,000, any remaining "Segal matters" not theretofore converted into cash or its equivalent, must be delivered to the contributors.

If the aggregate of realization never reaches that sum, any right of reimbursement to contributors will thereupon end.

There is some question whether the proceeds of realization shall not be kept separately accounted for and any income derived from investment credited to the contributors; but I cannot bring my mind to the conviction that such is the right of the matter.

I can only see my way to an allowance to them of everything derived in cash or its equivalent from the original assets until conversion, and an allowance upon the conversion of each asset of the amount in cash or its equivalent derived therefrom.

It may be urged that my interpretation is inconsistent and that there is no more reason why the income of the original assets should be credited to the contributors' account than that the income of the proceeds should not thus be credited.

Notwithstanding the possible inconsistency, it would seem to me to be abnormal to compel the company, after the asset had
62 reached its ultimate form, i. e., conversion into cash or its equivalent, to require that the cash or its equivalent, should continue to be invested and reinvested.

Of course the company is not entitled to demand that the realization from the "Segal matters" shall be $3,000,000 plus interest. It is too clearly stated that when the amount of realization is in excess of $3,000,000, the right of the contributors attaches, to construe these words "in excess of $3,000,000 and interest."

Interest is to be allowed in case of an excess sufficient in amount; but it is to be allowed only to the contributors upon the amount of their contributions.

In my judgment, therefore, the contributors are entitled to any excess in the realization of the "Segal matters" which will arise after there has been received from the "Segal items" by way of proceeds of sale, and income anterior to their conversion, the sum of $3,000,000.

I have had the benefit in investigating the subject, of the opinion prepared by the executive committee and the pertinent remarks and reasoning of Mr. Earle.

In answer to a question which has been put to me I say, that in case of misunderstanding or difficulty as to the administration of any of the assets, it would be quite legal for the company's board and the committees representing the contributing directors, to reach an understanding; but I do not think that the company in the administration of the assets, has any other duty than that of honest administration, to the best of its ability, and I do not thing that it is bound to consult

the contributing directors, although it is proper that such consultation shall be had.

Perhaps I should add that I do not agree with the theory of the committee that the contributors are entitled to a credit of $775,000 or any amount fixed as the value of the "Segal matters" at the time of the plan. There is to be no taking into consideration of
63 any values excepting those which should be realized. Should that realized be in excess of $775,000, it would be to the advantage of the contributors pro tanto; but should it be less than that amount, the contributors certainly are not entitled to this appraised or, for the time being, accepted value.

July 15, 1915.

JOHN G. JOHNSON.

Petitioner's Exhibit 4

Whereas at the reorganization of "the Real Estate Trust Company of Philadelphia" sundry of the directors made contributions of $2,500,000, subsequently increased to $2,505,000, to further the same because of an apparent depreciation in the value of the so-called "Segal matters," upon terms as set forth in the circular and contract relating thereto, inter alia, as follows:

"The contributors to the $2,500,000 made such contribution with the understanding that if these 'Segal matters' shall be so administered as to realize an amount which would make the capital and apparent surplus whole, they should receive from the company any excess over said amount.

"If these matters, when administered, shall realize, in cash or its equivalent, to the company an amount in excess of $3,000,000 (representing the supposed formed capital and surplus), any such excess, so realized, as realized, shall, from time to time, be paid to said contributors in proportion to the amounts by them respectively contributed.

"Until the amount of their contributions, with interest, shall have been reimbursed, said 'Segal matters' shall constitute part of the assets or capital of the company, subject only to this provision of conditional payment of excess to said contributors."

64 And whereas in a matter so complicated and fraught with the possibilities of subsequent difference of opinion and interpretation, it was thought desirable that plenary and irrevocable power should be placed in a committee of the contributing directors for the purposes of adjustment with the Real Estate Trust Company of Philadelphia should difficulties arise, as is set forth in said contract (a copy of which is attached hereto, marked "Exhibit A").

And whereas such divergencies of opinion have arisen which may require litigation to decide, or necessitate an immediate disposal for the administration of the remaining assets, which is deemed to be inadvisable by both the committee and trust company; and it is deemed advisable in the interest of all concerned in such assets to

presently settle finally all questions raised, or which might or could be raised, as to the future administration of such assets, and to finally define the complete method and character of such administration.

Now, therefore, it is agreed by and between the said committee of directors as now constituted, and acting on behalf of all the contributors, and the said "the Real Estate Trust Company of Philadelphia";

First. That all of the "Segal items" are to be and remain part of the permanent capital and assets of the said the Real Estate Trust Company of Philadelphia, in complete and undisputed ownership.

Second. That an accounting is to be made of such assets as have been so far realized upon, and also, from time to time, of such amounts of principal as come from the Altoona mortgages, and the sums thus ascertained and received are to be applied, as far as possible, to the liquidation of the claim of the Real Estate Trust Company of Philadelphia for the said $3,000,000 against such assets.

65 Third. That out of any income or dividends received hereafter by the Real Estate Trust Company of Philadelphia during each calendar year from such assets as are not already disposed of, five per cent, per annum shall be first paid to the said the Real Estate Trust Company of Philadelphia, but not cumulatively, upon such balance of said $3,000,000 as remains unliquidated, from time to time; three per cent, per annum, but not cumulatively, shall be next paid upon any balance of said $2,505,000, remaining unreturned, pro rata and proportionately, to the contributors of the said $2,505,000 fund; and if there be any further remainder of such income in any such year, it shall be applied, first, to and towards the entire liquidation of the remainder of the $3,000,000. First due from such assets as aforerecited to the Real Estate Trust Company of Philadelphia; and when that is completely liquidated, then any remainder shall be applied to and towards the entire liquidation of the remainder of the $2,505,000 due secondly to the said contributors, without interest.

Fourth. That as a further consideration and adjustment that would make possible the participation of the contributors to the $2,505,000 fund so as to secure at least some return upon their equity, it is hereby provided and agreed that should the Real Estate Trust Company of Philadelphia, in its discretion, dispose of any or all of the stock of the Pennsylvania Sugar Company, owned by the trust company as part of the "Segal matters" twenty-five per cent of the proceeds of such sale or sales, or so much thereof as may be required to return the contributions without interest, shall thereupon be distributed pro rata among the contributors to the said $2,505,000 fund on account of their contributions up to the amount of the same, which at that time shall remain unreturned. The remainder

66 of the proceeds of any such sale or sales shall be and remain the absolute property of the Real Estate Trust Company of Philadelphia.

In witness whereof, the parties hereto, being members of a Committee of the board of directors of the Real Estate Trust Company of Philadelphia, composed of members of the board who were not contributors to the reorganization fund of the Real Estate Trust Company of Philadelphia, to whom this matter has been referred, with power to act, and acting on behalf of the Real Estate Trust Company of Philadelphia, and the members of a committee of the contributing directors to the reorganization fund of the Real Estate Trust Company of Philadelphia, and acting for themselves and the other contributors to the aforesaid fund, have hereunto set their hands and seals, this fifth day of May, A. D. 1916.

Sealed and delivered in the presence of:

JNO. A. MCCARTHY
R. EDWARD IVES as to R. DALE BENSON
JNO. A. MCCARTHY
JNO. A. MCCARTHY
R. EDWARD IVES as to JOHN GRIBBEL

(Signed.)

S. F. HOUSTON [SEAL.]
R. DALE BENSON [SEAL.]
W. A. PATTON [SEAL.]
G. H. EARLE, JR. [SEAL.]
RICHARD Y. COOK [SEAL.]
Chairman.
JNO. GRIBBEL [SEAL.]

67 EXHIBIT A

Whereas, Dale Benson, John F. Betz, John H. Converse, W. A. Patton, E. P. Borden, S. Weir Mitchell, Joseph deF. Junkin, S. F. Houston, Bayard Henry, Frank C. Roberts, and W. W. Porter contributed the sum of two million five hundred thousand dollars ($2,500,000) in order to make effective the plan of reorganization of the Real Estate Trust Company of Philadelphia, and it was thereupon agreed by the said the Real Estate Trust Company of Philadelphia that after the payment to it of the sum of three million dollars ($3,000,000), to be realized from what are known as the "Segal claims" any sum or sums in excess of the said three million dollars ($3,000,000) should be applied to the reimbursement of the parties hereinabove named in the proportions of their respective contributions;

And whereas it is deemed advisable that a committee of three persons of the above named contributors of the said two million five hundred thousand dollars ($2,500,000) should be appointed with plenary powers to act on behalf of all of the contributors as aforesaid in any transaction or transactions where the "Segal claims" may be involved, with the end in view of disposing of the said "claims."

And now this agreement witnesseth that the parties hereto, being all of the contributors to the said fund of two million five hundred thousand dollars ($2,500,000) paid as aforesaid, for and in consideration of the mutual covenants, promises, and agreements herein contained, do covenant, promise, and agree to and with each other as follows:

I. John H. Converse, Samuel F. Houston, and R. Dale Benson, are hereby appointed a committee of three, as agents, representatives, and attorneys for all of the contributors to the reorganization fund of two million five hundred thousand dollars ($2,500,000) paid to the Real Estate Trust Company of Philadelphia, by the undersigned, with full power to do any and all things, execute any and all documents, enter into any and all negotiations and agreements respecting the "Segal claims" of the Real Estate Trust Company of Philadelphia, for the purpose of realizing upon the said "claims" with the same force and effect as though each one of the said contributors to the said reorganization fund in his individual capacity was acting in the premises, and any or all things done and performed, whether in the form of compromises, adjustments, agreements, or otherwise, in any way whatsoever, shall be as though done and performed by each one of the contributors to the said reorganization fund and the parties to this agreement.

II. The said committee, consisting of Messrs. Converse, Houston, and Benson, shall be self-perpetuating, and upon the death or incapacity of any one or several of the said committee the survivor or survivors may select from the parties hereto an additional member or members to make up the full membership of three, as herein provided.

III. The appointment of the said Converse, Houston, and Benson is irrevocable, except as hereinafter provided, and is binding upon the heirs, executors, administrators, and assigns, of the parties hereto; and in the event of the death or incapacity of any of the parties hereto, this agreement shall not be revoked thereby, but shall be deemed to be in full force and effect and binding as aforesaid upon the heirs, executors, administrators, and assigns of the parties hereto.

IV. At any time hereafter, by a writing or writings duly executed by parties holding or legally representing three-fourths of such contribution, this instrument may be modified, or entirely revoked and cancelled, in such manner as such majority may determine and direct.

In witness whereof, we have hereunto set our hands and seals this day of November, A. D., 1907.

Witnesses:

Petitioner's Exhibit 5

This agreement, made this thirtieth day of December, in the year of our Lord one thousand nine hundred and twenty (1920), between the Real Estate Trust Company of Philadelphia, a corporation organized under the laws of the State of Pennsylvania (hereinafter called trust company), and Samuel F. Houston, of the city of Philadelphia, State of Pennsylvania (hereinafter called Houston)

Whereas, Samuel F. Houston, as a director of the Real Estate Trust Company of Philadelphia, contributed the sum of seven hundred and fifty-five thousand dollars ($755,000.00) to the fund created

by various directors of the company, in accordance with a plan of reorganization formulated as of September 12th, 1906, which said plan was formally approved by the banking commissioner of Pennsylvania and by the court having jurisdiction of the subject matter at that time. The rights of the contributors and the trust company to the said fund are further set forth in an agreement dated May 5th, 1916, which plan and agreement, by this reference thereto, are made part hereof:

70 And whereas "Converse committee," herein referred to, was a committee appointed by agreement dated the day of November, 1907:

And whereas the contributing directors, with the amounts of their contributions to the said reorganization fund, are as follows:

John H. Converse	$1,908,000.00
Samuel F. Houston	735,000.00
John F. Betz	153,375.00
William A. Pattee	103,000.00
R. Dale Benson	100,625.00
Bayard Henry	82,500.00
Edward P. Borden	77,000.00
W. W. Porter	75,000.00
Frank C. Roberts	75,000.00
S. Weir Mitchell	52,500.00
Joseph DeF. Junkin	11,000.00

And whereas Houston and trust company have reached an agreement finally settling and determining their respective rights and interests in said fund and under said plan of reorganization and agreement of May 5th, 1916, whereby the said Houston is entitled, subject to the conditions hereinafter set forth, to five hundred and forty-eight and seven hundred and thirty-four thousandths (548.734) shares of stock of Pennsylvania Sugar Company;

Now this agreement witnesseth that the parties hereto, for and in consideration of the mutual covenants and agreements hereinafter set forth, do covenant, promise, and agree to and with each other as follows:

First. Trust company will assign, transfer, and deliver to Samuel F. Houston five hundred and forty-eight and seven hundred and thirty-four thousandths (548.734) shares of its holdings
71 (amounting in all to seventy-two hundred and sixty-eight (7,268) shares) of the capital stock of Pennsylvania Sugar Company which have grown out of the "Segal matters," referred to in said plan of reorganization.

Second. Said Houston hereby accepts said five hundred and forty-eight and seven hundred and thirty-four thousandths (548.734) shares in full settlement and release of all his rights of, in and to any of the matters growing out of said reorganization fund of two million five hundred thousand dollars ($2,500,000), and under or by virtue of said plan of reorganization and agreement dated May 5th, 1916, and does hereby remise, release, quitclaim and confirm unto the said trust company all of his right, title, and interest in

and to all of the assets and property, of every kind and description, known as the "Segal matters," or growing thereout, or which are the result of any asset or right which the trust company had or was entitled to at the time of said reorganization, so that the same shall be the absolute property of trust company, free and discharged from all trusts, contracts, or claims of whatsoever kind or nature growing out of said reorganization plan or said agreement of May 5th, 1916, or otherwise; and does further remise, release and discharge the said trust company, its officers, directors, and stockholders, of and from all claims and demands growing out of or by reason of said contribution of seven hundred and fifty-five thousand dollars ($755,000), and hereby confirm and approves all that has been done, or omitted to be done, by either the trust company, its officers, directors, or employees, or by said Pennsylvania Sugar Company, its officers, directors, or employees, in the administration of the said "Segal matters" or of the property of said sugar company.

Third. For a period of five years from the date of this
72 agreement, Houston shall not have the right to, and covenants that he will not, sell, assign, or otherwise, dispose of the shares of the stock of said sugar company delivered hereunder until he has given, in the manner hereinbefore provided, to the other contributing directors and to the Real Estate Trust Company of Philadelphia the right to purchase the same at the highest price that he is then offered in good faith for the same. In the event that Houston shall receive any bona fide offer to purchase all or part of said stock at a price which he is willing to accept, he shall notify in writing said The Real Estate Trust Company of Philadelphia of the fact and terms of such offer, and such company shall have five days from the day on which notice is received to purchase said stock for cash at the same price; in the event that said The Real Estate Trust Company of Philadelphia does not purchase within said period, then Houston shall be relieved from the restrictions and obligations of this paragraph to the extent of the stock covered by said offer, and Houston shall be free to dispose of the same without regard to this agreement. If the said The Real Estate Trust Company of Philadelphia does exercise its right to purchase said purchase shall be for account, first, of such contributing directors as shall, on demand, actually pay for their pro rata share of the stock offered (it being understood that if any contributing director does not actually pay for his pro rata share, then the other contributing directors, in the proportion of their respective holdings, shall have the right to purchase and pay for on demand), and, second, to the extent that the offered stock shall not be taken and paid for by the contributing directors, said trust company may still elect to purchase in its own right.

Rights to subscribe to the stock of the Pennsylvania Sugar Company, which may hereafter accrue by virtue of Houston's holdings of stock delivered hereunder, shall be subject to the same

73 terms, conditions, and restrictions as are above set forth; and if Houston declines to exercise said rights and is unable to sell or dispose of the same in the way and manner hereinbefore set forth, said rights shall be, pro rata, assigned to the other contributing directors, in proportion to their then holdings of stock delivered to them under this agreement, at least five days before the expiration of the time when said rights must be exercised. No provision in this agreement shall limit or restrict the disposal of the stock covered hereby either by will or under the intestate laws, or in pursuance of any decree of distribution based upon any will or the provisions of the intestate laws, but the persons taking the same shall be subject to the same limitations, as to the sale or disposal thereof, as by this agreement are imposed upon the said Houston.

Fourth. "Contributing directors" shall mean, whenever used in this agreement, any of the original contributors to the reorganization fund (or the representatives, either in fact or in law, of those contributing directors who are deceased or incapacitated) as shall become parties to this agreement.

Fifth. Said Houston hereby releases, quitclaims, and forever discharges the converse committee, and each and every member of said committee, past as well as present, of and from all claims and demands for or by reason of any act done, or omitted to be done, by said converse committee, and further hereby confirms and ratifies all acts done by said converse committee, and approves of the course taken by said committee as to anything omitted to be done.

Sixth. This agreement is made upon the express condition that in the event of the failure of the stockholders of trust company, at its next annual meeting, to approve and confirm the action of its 74 officers and directors in entering into this agreement, trust company shall have the right to revoke this agreement, and thereupon it shall become the duty of said Houston to reassign and transfer to trust company said five hundred and forty-eight and seven hundred and thirty-four thousandths (548.734) shares of Pennsylvania Sugar Company stock and any new issue of said Pennsylvania Sugar Company stock to which said Houston may become entitled to subscribe by virtue of his record holding of said hundred and forty-eight and seven hundred and thirty-four thousandths (548.734) shares, and for which he has actually subscribed and paid for, together with any dividends that may have been declared and paid thereon in the interim; for any new stock so subscribed and paid for by Houston, trust company shall pay him the amount paid by him with interest at six per cent. In the event of said revocation, the rights of the parties hereto shall be saved and remain as defined and stated in the agreement of May 5th, 1916, joined in by the said Houston.

Seventh. This agreement, although signed only by the said Houston, shall, with other identical agreements with such contributing

directors as shall sign same, constitute one agreement, with the same force and effect as if all of them had signed one instrument.

Eighth. All certificates of stock delivered to the said Houston shall have thereon endorsed the following:

"This certificate of stock is subject to the terms and conditions of a certain agreement dated the thirtieth day of December, 1920, between the Real Estate Trust Company of Philadelphia, of the first part, and Samuel F. Houston, of the second part, and may be transferred only under and subject to said agreement, a copy of which is lodged with the Real Estate Trust Company of Philadelphia."

75 Ninth. The Real Estate Trust Company of Philadelphia agrees that if at any time hereafter it undertakes to negotiate a sale of all or any part of its holdings of stock in said Pennsylvania Sugar Company, it will, if the said Houston then desires to sell, endeavor, in so far as it can, to effect a sale of the stock of the said Houston upon the same terms and conditions as it sells its own stock.

Tenth. This Agreement shall bind the parties hereto, their legal representatives, successors, and assigns.

In witness Whereof the corporate party hereto has caused its common or corporate seal to be hereunto affixed duly attested by its proper officers, and the individual party hereto has hereunto set his hand and seal, the day and year first above written.

Sealed and delivered in the presence of:

THE REAL ESTATE TRUST
COMPANY OF PHILADELPHIA,
By GEORGE H. EARLE, Jr., (Signed.)
President.

Attest:

WILLIAM R. PHILLER, (Signed.)
Secretary.

SAMUEL T. HOUSTON, (Signed.)
BENJ. F. MOORE (Signed.) [SEAL.]

76 *Petitioner's Exhibit 6*

OFFICE OF COMMISSIONER OF INTERNAL REVENUE.

IT:PA-3
AUS-306-App.

Mr. SAMUEL F. HOUSTON,
Druim Moir, Chestnut Hills, Philadelphia, Pa.

SIR: An examination of your income tax return and of your books of account and records for the year 1920 discloses an additional tax liability for that year aggregating $191,880.53, as shown in detail in the attached statement.

In accordance with the provisions of section 250 (d) of the revenue act of 1921, you are granted thirty days within which to file an appeal

and to show cause or reason why this tax or deficiency should not be paid. The appeal, if filed, must be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the specific attention of IT:PA:3-AUS-306-App.

Treasury Decision No. 3492, setting forth the privileges of taxpayers in cases of appeal, is attached for your information and guidance.

Where a taxpayer has been given an opportunity to appeal and has not done so, as set forth above, and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement of the assessment will be entertained.

This assessment is in addition to all other outstanding and unpaid assessments appearing upon the collector's lists.

77 Payment should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Respectfully,

J. G. Bright, (Signed.)
Deputy Commissioner.

Inclosure:
T. D. 3492.
Statement.
IT:PA-3
AUS-306-App.

STATEMENT

In re: Samuel F. Houston, Druim Moir, Chestnut Hills, Philadelphia, Pa.

1920

Additional tax—$191,830.53

The report of the internal-revenue agent in charge at Philadelphia, Pa., dated December 15, 1923, has been approved by this office, except that the loss claimed in the amount of $271,700.00 on account of the Real Estate Trust Company transaction is disallowed and contributions are increased to $44,379.91, the full amount reported on your return, as they do not now exceed 15 per cent of net income.

In regard to the disallowance of $271,700.00, you are advised that under the provisions of revenue act of 1918 no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of, and the evidence is to the effect that the stock was still in your possession at the close of the year 1920.

The net income as adjusted is $432,355.88 and the tax liability is $220,894.20.

As $27,363.89 has been assessed, there is an additional tax liability of $191,830.53.

78 *Petitioner's Exhibit 9.*

FEBRUARY 11TH, 1915.

To the Board of Directors of "The Real Estate Trust Company of Philadelphia."

GENTLEMEN: The undersigned committee, which was appointed by your body to consider and report upon the so-called "Segal matters" and the relations of all parties thereto, and which committee was composed of Messrs. Converse (since deceased), Houston, Junkin, and Roberts, have had many conferences upon the subject which was referred to them, and they beg herewith to submit the results at which they have arrived and the conclusions which seem to them to be apparent therefrom. They attach hereto a separate statement, prepared by a member of the original committee, in which the remaining members thereof entirely concur and in the course of action therein recommended as to the future concerning the treatment of the "Segal matters."

As these conclusions apparently raise new questions which have not heretofore been discussed concerning these "Segal matters," and if such conclusions are correct they become vitally important for the future treatment of the "Segal matters" and their proceeds in the affairs of the company, your committee would recommend that this report and such conclusions be referred to John G. Johnson, Esq., for his opinion as to the soundness thereof or as to any suggestions which he may have to make as to the whole situation. Manifestly the time has arrived when some definite policy should be adopted and adhered to for the future in the treatment of these assets and their proceeds. The large interest represented by the stock holding of this company in the Pennsylvania Sugar
79 Company, and which grew out of the "Segal matters," renders it essential, in the opinion of the committee that this whole question should be presently and finally determined.

The committee has also ascertained that apparently the provision of the plan of reorganization of September 12th, 1906, which was adopted by the stockholders, has not been complied with, where in paragraph 4, in connection with the "Segal matters," it is provided "A schedule of such items to be filed with the commissioner of banking to prevent future controversy." This appears from the correspondence hereto attached between a member of the committee and the present commissioner of banking.

It is manifest from this correspondence also that the item mentioned in his first letter, which correspond with the items carried by the treasurer in his book in connection with the "Segal matters," constitute the details of the schedule which should have been filed, and which, in the opinion of the committee, should now be filed formally with the commissioner of banking, and filed by the gentlemen who were appointed under the agreement made in November, 1907, between the contributing directors themselves, who therein appointed Messrs. Converse, Houston, and Benson as a committee to represent

the contributing directors in all matters affecting the Segal assets in so far as they related to the contributing directors' interests. This schedule should also be signed by the officers of the corporation as being the agreed upon schedule between such contributing directors and the company.

We also append hereto a copy made from the special book kept by Mr. Edward S. Buckley, jr., treasurer of the company, in connection with the Segal collaterals, which, the treasurer states, contain all entries of all transactions concerning such securities since the
80 reorganization of the company on November 1, 1906, and which show in detail of what such assets consisted, the amounts in cash that have been received on account of the same, both principal and income to date, and also such securities as have been received in every instance in exchange for or in lieu of any of the original securities.

We also attach hereto a statement prepared by John A. McCarthy, Esq., trust officer of the company, on June 20th, 1912, explaining in detail the different steps which were taken and the results of the same in connection with such assets up to that date, together with a further letter from such trust officer, dated December 28th, 1914, bringing his report on the same down to the date of such letter.

We also append hereto copies of the original letter of Mr. Earle to the stockholders, dated September 12th, 1906, and of the plan of reorganization dated October 24th, 1906.

We also append hereto a copy of the agreement made by the contributing directors appointing the aforesaid committee to represent them in November, 1907.

Assuming that the conclusions arrived at by your committee are found to be correct and approved by Mr. Johnson, the net result of the situation appears to be that whether the "Segal matters" are treated as having been approved by the banking commissioner and accepted by the company as equivalent on November 1, 1906, to a total asset in hand equalling at least the sum of $775,000 for purposes of calculation in full paying the then outstanding stock issue, both common and preferred, or whether the result of the administration of the same has produced that which is equivalent to $775,000 and more in the present assets of the company, it follows that at least the entire original capital of $1,500,000 has been restored; and that upon November 1st, 1906, there remained still to be
81 realized from all of the assets appraised at that time at the sum of $1,500,000, a further sum representing the surplus carried upon the books of the company at the time of the failure of $1,500,000, before the contributing directors become entitled to any of the proceeds of the "Segal matters"; and that against such latter sum there should be credited the cash sums which have been received by the treasurer of the company as the result of the Segal assets, as shown by his accounts (a copy of which is hereto attached), aggregating a total sum of $200,362.95; and that in the future against

the same sum should be credited all principal sums received by the company from the disposition of such assets and all income therefrom until the same is entirely liquidated, and from that time on the contributing directors would be entitled to the proceeds of the administration of such assets.

Should the chief Segal asset remaining, to wit: The stock of the Pennsylvania Sugar Company, be found at any given time, by reason of the success of the company, to have an actual value sufficient to more than extinguish whatever may be the remaining amount due upon such deficiency, it appears to your committee that at that time the situation is one then open to negotiation and settlement between the company and the contributing directors as to the disposition of such assets or the adjustment of the same between them and the company, and, if the sugar company is as successful as it is anticipated and hoped, the attainment of such much-to-be-desired result apparently need not be a matter of very long time.

Respectfully submitted by:

(Signed) S. F. Houston.
Frank C. Roberts.
Joseph deF. Junkin.

82 Samuel F. Houston, called as a witness on behalf of petitioner and being duly sworn, testified in part as follows:

DIRECT EXAMINATION

In 1906 I was a director of the Real Estate Trust Company of Philadelphia, and a member of a committee of the directors, known as the Converse committee, created by the agreement entered into by all of the subscribers of the guaranty fund. I was familiar with the steps taken to secure the appointment of George H. Earle, jr., as receiver, and the steps taken thereafter leading up to the reorganization of the company and its reopening for business on November 1, 1906. I participated in the conferences with the receiver concerning the formulation of his plans, and after the company reopened I was a member of its board of directors. I was familiar with the formation of the plans for the guaranty fund and for the administration of the Segal assets, and had almost daily talks with the receiver and my fellow directors concerning these plans. I subscribed to the guaranty fund, and in making my subscription I understood that I was to look to the administration of the Segal assets as the source from which I would receive a return on my investment. Representation and expressions of opinion were made by Mr. Earle, the receiver, to the subscribers concerning the prospect of realizing on the Segal assets. Mr. Earle was most sanguine of the Segal assets proving of sufficient value to repay every cent that was put into the guaranty fund with interest and possibly with a profit. I was familiar regarding the Segal assets. In considering their prospective value it is

necessary to fix the time in question, for we had a very different mental attitude at the time the agreement was entered into. At that time we thought that the Segal assets had a very potential
83 value. The receiver and the parties to the guaranty fund had almost daily discussions concerning the manner of working out the so-called Segal assets, and at that time I had the opportunity to form an opinion concerning the working out of the Segal assets in accordance with the plan. I reached the conclusion that the administration of the Segal assets according to the terms of the agreement as outlined by Mr. Earle would result in our getting back our contributions with interest and possibly with a profit. In 1915 a difference of opinion arose upon the proper interpretation of the original agreement. The so-called guaranty-fund agreement was referred to Mr. John G. Johnson, who rendered his opinion in July 15, 1915. Following Mr. Johnson's opinion, the so-called supplemental agreement of May 5, 1916, was entered into, and I was a party to that agreement. The administration of the Segal assets thereafter by the Real Estate Trust Company was controlled by that supplemental agreement until, in the latter part of 1920, all of the parties reached an agreement that the administration had accomplished its purpose and that the assets should be distributed in kind. At the time the agreement of 1916 was entered into by me I was of the opinion that if the sugar company was as successful as we anticipated and hoped the much-desired result that the Real Estate Trust Company would work out from the Segal assets a sum sufficient to return to the subscribers the amount of their contributions need not be a matter of very long time.

I executed the agreement of December 30, 1920, and received my proportionate share of the Pennsylvania Sugar Company stock thereunder. I personally was entitled to 222 shares. I received the stock On December 30, 1920. I took my loss in 1920, and I charged it off at that time. With regard to Mrs. Henry, I had discussions
84 with her about the working out of the assets after she had made her subscription of $200,000 to the fund. I reported to her from time to time about the affair. I talked to her casually about things and I called to her attention important matters, such as the making of the agreement of 1916. As a matter of fact, I represented her in the matter, and after her subscription was made I acted for her. After I received the number of shares that the subscription in her name entitled her to, I gave her the shares which were received through me. That was in 1921. At the time that she made her subscription I told her that here were all of the securities and we believed them to have a value of considerably more than the value of the contribution.

CROSS-EXAMINATION

With regard to the dealings in making the subscription, I represented Mrs. Henry at the very beginning to the extent of $200,000; that is, the subscription was made in my name for her. I continued

to represent her in the matter until the agreement of December 30, 1920. In December, 1920, I received approximately .527 shares of stock in the Pennsylvania Sugar Company for myself individually, and for the different persons who helped me to contribute the $755,000. In other words, I received an allotment of shares equivalent to the percentage which the $755,000 bore to the entire subscription amount. I received all of said shares at one time.

Although I expressed an opinion during the direct examination that the Segal matters had a value greater than the amount of the subscription, it is a matter of fact that some $5,000,000 were supposed to have been lost through the Segal matters by the Real Estate Trust Company in 1906. Certain collateral consisting of stock in the Pennsylvania Sugar Refining Company had been wrongfully released and had become subject to the prior lien of another creditor.

85 I do not recall all of the steps in the plan for reorganization but the first step was that of offering notes of the directors to the extent of $3,000,000 to the clearing-house committee in order to keep the company from failing. That plan did not go through, however; the company did fail. Subsequently, the directors reached an agreement to place $2,500,000 in cash with the company to enable it to reopen and carry on business.

There were other considerations for the directors going forward with these subscriptions. Mr. Earle, the receiver, in his letter to the stockholders, had suggested the possibility of double liability on their part with the probability of extended litigation over the matter. He had also suggested the possibility of liability on the part of the directors, although he stated to the directors frequently that in his opinion they had no personal responsibility. There was also the fact that the Real Estate Trust Company had been a going organization since 1883 or 1885; the real question in the minds of Mr. Earle and the directors was a speedy reopening of the company. That was the prime consideration. I was one of those who offered to submit my note to the clearing house in order to avoid the appointment of a receiver and in order to continue the business of the company. After the receiver was appointed the prime consideration was the reopening for business.

At the time of my subscription to the reorganization there was no valuation made of the Segal assets, but the banking commission agreed to accept them at a value of $755,000. Mr. Johnson, also, said in his opinion that they were valued at or nearly $755,000. It was the acceptance of that valuation that enabled the total subscription to be limited to $2,500,000 instead of the $3,000,000 originally proposed.

Among the so-called Segal assets there were a whole lot of
86 other securities besides the stock of the Pennsylvania Sugar Refining Company. We were so busy with other things that we did not have time to really find out what the values were. Mr. Earle, the receiver, attempted to liquidate those other securities and that liquidating was done very shortly after the company reopened,

or even during the receivership, I have forgotten which. I should say that the securities other than the stock of the Pennsylvania Sugar Refining Company had very largely been administered in 1911. I would not say all, but perhaps so.

In February, 1915, our viewpoint was optimistic. The stock of the Pennsylvania Sugar Company was the main asset; as far as I recall, it was practically the only one. And the outlook for the Pennsylvania Sugar Company, at that time, was exceptionally good because of conditions resulting from the war and the tariff.

John A. McCarthy, called as a witness on behalf of the petitioner, having been duly sworn, testified in part as follows:

I am a member of the bar of Philadelphia and was in practice in 1906 and was of counsel for George H. Earle, jr., as receiver for the Real Estate Trust Company. I became and still hold the office of trust officer of that company. I was familiar with the plans for reorganization and attended meetings between the receiver and the directors. I was familiar with the Segal assets and the terms of the plan for reorganization, which included the subscriptions to the guaranty fund. Prior to and at the time the subscriptions to the guaranty fund were made, I was present when Mr. Earle discussed the potential values of the Segal assets, and I personally formed my own opinion concerning them. I was of the opinion in 1906 that there was a very reasonable expectation that the Segal assets,
87 if properly worked out and properly handled in those cases where liquidation was necessary, would more than equal the amount of the contributions of the directors. I thought that everyone who contributed to the fund, and had so stated to them, would receive back their money in full and subject to a reasonable business risk, there would be a substantial profit. My statement was made at a meeting when the receiver and the members of the board, including Mr. Houston, were assembled. I was of counsel in the litigation against the American Sugar Refining Company, and I am familiar with that litigation and the settlement which resulted from it out of which the stocks and bonds of the Pennsylvania Sugar Refining Company were received. That suit was under the Sherman Act and it was compromised in January, 1910.

I was secretary and treasurer of the Pennsylvania Sugar Company and I was also trust officer of the Real Estate Trust Company. I attended to the duties of putting through the liquidating agreement of December 30, 1920. That agreement was signed on December 30, 1920, by Mr. Houston. I imagine the converse committee approved it on the same day. I received the stock which was given to Mr. Houston under that agreement. I received that stock on December 30, 1920, or the day before, and my recollection is clear that I delivered it to him on that day.

With regard to the liquidation of the Segal assets, there were a great many items back in 1906 and I should say that a great many of them had been cleared up by 1911. The reorganization of the Penn-

sylvania Sugar Refining Company was effected on January 22, 1912. I think that by that time there were only about two securities which remained unliquidated. There may have been one or two more minor ones, I am not sure. Outside of the sugar company stock the great bulk of the matters had been cleared up prior to 1912.

88 Mrs. Sallie Houston Henry, called as a witness on behalf of the petitioner, and having been duly sworn, testified in part as follows:

DIRECT EXAMINATION

My name is Sallie Houston Henry, of Chestnut Hill, Pennsylvania, and I am the petitioner in the matter pending before the United States Board of Tax Appeals. I was one of those who contributed to the so-called guaranty fund in the reorganization of the Real Estate Trust Company of Philadelphia. I was not a director of that company but I was a stockholder holding 1,071 shares. I knew of the plans for the reorganization from my talks with my brother, Samuel F. Houston, who was a director of the company, and from the letters received from George H. Earle, jr., receiver. It was my understanding from what Mr. Houston said, with Mr. Earle's authority, that the money I put in would be returned, and if there was any money over and above the promised subscription, that would be divided among the people who had subscribed to this fund. Following the time of my subscription and down to 1920 I do not think that anyone ever told me that I would not receive my subscription back.

In 1920 I consented to my brother entering into an agreement with the Real Estate Trust Company on my behalf, as well as on his own behalf, to cancel the agreement in relation to the trust fund or the guaranty fund and make a distribution of the stock of the Pennsylvania Sugar Company. In 1921 I received through my brother my number of shares of stock of the Pennsylvania Sugar Company. I did not receive anything else other than those shares as a result of my contribution of $200,000 in 1906. Mr. Houston acted for me entirely throughout the transaction. I never appeared at any of the meetings or in any personal way at all.

89 CROSS-EXAMINATION

I do not know how it happened that my brother took up the matter of reorganization with me. I was interested in the Real Estate Trust Company and it was in great straits, and naturally we subscribed the money to put it on its feet again. What the trust company needed was cash to carry on. At the time this was taken up I talked regarding the matter with Mr. Bayard Henry and Mr. Houston. I did not know until the other day that Mr. Houston subscribed $755,000 because, as I tell you, the thing was in this very disagreeable position, and from the point of view of a director, he felt that it was his duty

to help to collect the cash. As I tell you, what they needed was cash to carry on, and it was his point of view to get the cash together to help out and then with Mr. Earle's ideas, they thought that would be able, as they were able, to put the thing on its feet again. It was what you might call a business enterprise so that the Real Estate Trust Company would not be compelled to liquidate, but would open its doors and carry on business. I do not know whether Mr. Houston said anything at the time with reference to the possible liability of the directors. Of course, they felt that they had a moral liability, but I never felt they had any other, and I do not know that Mr. Houston said so.

Mr. Earle must have sent me a copy of the plans for reorganization as I was a stockholder and also a depositor. I really do not know whether Mr. Houston asked me to become a subscriber or whether I volunteered. However, I made my payment of $200,000 direct to Mr. Houston and he in turn turned that in to the guaranty fund. At the time I made this payment I had no written agreement with respect to my understanding. It was my understanding that Mr. Houston was to assume no personal responsibility for the re-
90 payment of the $200,000 to me, but I fully understood that the company would be able to. That is what Mr. Earle kept saying all the time, that when the company got on its feet it would be quite able to return the money that was deposited for this emergency.

It was my understanding that whatever return was made to me of the $200,000 which I advanced through Mr. Houston to this guaranty fund was to come from the liquidation and working out of the Segal assets. Mr. Houston represented me in so far as my share of the contribution was concerned. The only notice that I had of the supplemental agreement was through him.

Q. At the time this guarantee fund was made up, the matter was considered to a great extent a question of honor, was it not?

A. Well, it was, yes. Of course, it was honor, but, at the same time, it was a business risk. All business is a matter of honor. If you don't have honor, you can't have honesty or anything else, as far as that is concerned. There is no question of that.

The reorganization was not concluded for a great many years after the original trouble. I was not aware of any negotiations prior to the time that the agreement of 1920 was entered into. As I said, as far as I was concerned, it was all in my brother's hands. I had loaned the money for this business venture, and when these details came up he attended to them. I suppose he told me about them afterwards, but I don't believe he told me about them before they happened. I don't think it was at all likely he did. I haven't the faintest idea when I first learned of the final agreement of December 30, 1920. As I say, I did not attend to the details of this business. It was in my brother's hands and he was attending to it for me. I do not consider myself a business person. He had done that all the way through from the very beginning. Whatever my brother had done in that con-

91 nection was acceptable to me. It was entirely in his hands. I don't consider myself a business person. I don't think I have a business head and I don't interfere with things of that kind.

(Sgd.) WM. CLARKE MASON,
Counsel for Petitioner.

(Sgd.) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

Approved this twenty-seventh day of June, 1929.

(Sgd.) BENJAMIN H. LITTLETON,
Member, United States Board of Tax Appeals.

Now July 1, 1929, the foregoing statement of evidence certified from the record as a true copy.

[SEAL.] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before U. S. Board of Tax Appeals

Præcipe for transcript of record

Filed April 17, 1929

To the Clerk of the United States Board of Tax Appeals:

You will please prepare a transcript of the record in the above-entitled cause to be filed in the office of the clerk of the United States Circuit Court of Appeals for the Third Circuit, at Philadelphia, Pa., under the appeal heretofore perfected to the said court by the taxpayer herein, and include in the said transcript copies duly certified as correct of the following pleadings, proceedings, and papers on file, to wit:

92 1. The docket entries of the proceedings before the Board of Tax Appeals.

2. The pleadings before the Board of Tax Appeals.

3. Findings of fact, opinion, and decision of the board.

4. Petition for review.

5. Statement of the evidence as it may be finally settled, agreed upon, or approved pursuant to the applicable rules.

6. Copies of petitioner's Exhibits Numbered 1, 2, 3, 4, 5, 6, and 9, attached to the statement.

8. This præcipe.

Said transcript to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Third Circuit.

WM. CLARKE MASON,
Attorney for Petitioner.

Dated April 17, 1929.

Service accepted:

_____,
Attorney for Commissioner of Internal Revenue.

Now, July 1, 1929, the foregoing præcipe certified from the record as a true copy.

[SEAL.] (Sgd.) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

93 In United States Circuit Court of Appeals for the Third Circuit

No. 4210. October term, 1929

SAMUEL F. HOUSTON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order substituting party respondent

Filed Nov. 15, 1929

In conformity with the stipulation of counsel filed herein, it is ordered that Robert H. Lucas, Commissioner of Internal Revenue, be substituted as respondent in the above-entitled cause for David H. Blair, former commissioner, and that the said cause be continued and maintained against the said Robert H. Lucas, Commissioner of Internal Revenue, as aforesaid.

Philadelphia, November 15, 1929.

Per curiam.

BUFFINGTON, *Circuit Judge.*

[File indorsement omitted.]

94 [Clerk's certificate to foregoing paper omitted in printing.]

95 In United States Circuit Court of Appeals

[Title omitted.]

Order assigning judge

Filed Jan. 13, 1930

And now, to wit: This 13th day of January, A. D. 1930, it is ordered that Hon. Albert W. Johnson, district judge for the middle district of Pennsylvania, be, and he is hereby, assigned to sit in above case in order to make a full court.

Per curiam:

BUFFINGTON, *Circuit Judge.*

[File indorsement omitted.]

96 Minute entry of argument and submission Jan. 13, 1930, omitted in printing.

97 In United States Circuit Court of Appeals for the Third Circuit

No. 4210. October term, 1929

SAMUEL F. HOUSTON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review from the United States Board of Tax Appeals

Opinion

Filed March 14, 1930

Before WOOLLEY and DAVIS, Circuit Judges, and JOHNSON, District Judge.

WOOLLEY, Circuit Judge.

Samuel F. Houston deducted a loss in his income-tax return for 1920 as though sustained in that year. The commissioner disallowed the deduction on the ground that there was not at any time a deductible loss, or, if such a loss in substance, it was not deductible because not sustained in that year, and assessed a corresponding deficiency tax. The United States Board of Tax Appeals approved the action of the commissioner. Thereupon Samuel F. Houston, by petition, brought the case here for review.

This is the outline of a case, exceptional in law because arising out of unusual circumstances, which, to understand the questions involved, must be stated at length.

The Real Estate Trust Company of Philadelphia closed its doors in the year 1906 because of financial embarrassment arising from misuse of its funds by Frank K. Hipple, its president, in financing projects of Adolph Segal, which consisted mainly in an attempt, through the Pennsylvania Sugar Refining Company, to contest the dominant position of the American Sugar Refining Company in the sugar trade. In this adventure the trust company became involved by accepting on its loans to Segal collateral of uncertain value and of a character that did not admit of ready liquidation. The trust company's affairs were further complicated by an unlawful withdrawal, with Hipple's permission, of collateral pledged on one of its loans to Segal and repledged by him as collateral for a loan of $1,250,000 made to him by Gustav E. Kissel. Included in this collateral were bonds and shares of the Pennsylvania Sugar Refining Company which had an importance beyond their money value because in connection with the loan there was an agreement between Kissel and Segal that until the loan was repaid, Kissel, or his nominee, should have the right to select four of the seven directors of

the Pennsylvania Sugar Refining Company and that its refinery should not be operated.

It soon became apparent that the trust company's financial embarrassment amounted to positive insolvency in that its capital and surplus had been swept away together with much of its deposits.

George H. Earle, jr., was appointed receiver. The situation was desperate. And this was so not only in respect to depositors but to the company itself, which had an extensive trust business, a substantial good will, and a valuable business location. It was plain that, if possible, these should be saved for all concerned.
98 The receiver immediately looked about for ways to reorganize the company, calling upon the eleven directors, who were charged by some with financial responsibility and who themselves felt a moral responsibility in the premises. There also arose a question of double liability upon the common stock. To bridge the situation the directors offered their notes in the sum of $3,000,000 on which to raise money and operate the company until its capital and surplus should be repaired. As obligations of this character were regarded an unsound basis for the reestablishment of a banking institution, the plan fell through. Finally the receiver evolved a plan—the one ultimately carried out—wherein each depositor should be paid one-third of his deposits in cash and in lieu of the balance he should be given shares of preferred stock of the company, especially issued for that purpose, and the board of directors should raise a fund, informally called the "guaranty fund," to which they should contribute $2,500,000 in cash and securities "to restore the present supposed capital and surplus." The character of the "guaranty fund" or of the directors' "contributions" will develop as we go along.

At the time of its failure the trust company held what became known as the "Segal securities," or, because of a necessary generalization, the "Segal matters," which designation included not only securities and transactions in the name of Adolph Segal but also other transactions brought about by him or in which he, in some way, directly or indirectly, was interested or had been concerned, aggregating about $5,300,000 and then having a value, so far as anyone could guess, somewhere between $300,000 and $775,000. In these Segal matters, that is, among the Segal intangibles, was a claimed right of action against and a hoped-for substantial recovery from
99 the American Sugar Refining Compny in a proposed suit for damages under the Sherman Antitrust Law. Perhaps as an inducement to the directors, or certainly by a representation made to them, the receiver's plan contemplated that all "Segal matters," tangible and intangible, should be retained by, and should constitute a part of the assets or capital of, the trust company, subject only to the provisional payment to the contributors to the guaranty fund to be stated presently, and that it should be administered by its receiver, and later by itself, to realize an amount which would make the capital and apparent surplus whole, stated at $3,000,000, and

that any excess of moneys realized and of profits earned thereon should, "from time to time, be paid said contributors in proportion to the amounts by them respectively contributed."

The eleven directors contributed to the guaranty fund in varying sums until finally it amounted to $2,505,000.

Samuel F. Houston, on a basis of 512 shares, contributed $755,000. Of this amount, he contributed $305,000 personally on his individual share holding; he contributed $200,000 on behalf of his sister, Sallie H. Henry; and the balance on behalf of his mother and another sister.

All this was done under a formal agreement between the trust company and the contributing directors bearing date October 24, 1906, the stockholders assenting.

With this fund and with relief from paying the depositors more than one-third of their deposits, the trust company opened its doors. George H. Earle, jr., its previous receiver, and its newly elected president, proceeded immediately to liquidate the Segal matters. Suit under the Sherman Antitrust Law was instituted against the American Sugar Refining Company for triple damages—$10,000,000—on the ground that Kissel, as agent for the American Sugar Refining Company, had made a contract with Segal in restraint of trade. This suit was compromised in 1910 and in 1911 or 1912 most of the other assets, with one very important exception, had been cleared up. That one—the major asset—was the trust company's interest in the Pennsylvania Sugar Refining Company, represented by 7,268 of its shares. Just what the trust company did in the business of the Pennsylvania Sugar Refining Company during the intervening years is not clear. At all events it held its stock and its stock acquired a value.

In 1915 a difference of opinion arose among the contributors to the fund as to their rights in the Segal assets which resulted in an opinion by John G. Johnson, Esquire, evidently acquiesced in by all parties, indicating that the whole title to the Segal assets was vested in the trust company, to be handled and liquidated solely within its discretion conformably with honesty and intelligent judgment; and that all the contributors had in the Segal matters was a right, after the trust company had realized and credited a sum of $3,000,000, to what was left.

In 1916 the trust company and the contributors—all the parties interested in the Segal matters—entered into a "supplemental agreement" in respect to the distribution of annual income or dividends, not here important except perhaps to confirm and throw light on the original agreement, including the intention and expectation of a return of the guaranty fund subscribed in 1906 with profits.

In 1920 the trust company's primary demand for the restoration of its capital and surplus in the sum of $3,000,000 having been realized, the company and the contributors to the guaranty fund were of opinion that the liquidation agreement had rendered its maximum of service and that the values of the remaining Segal

assets, shown in the latter part of that year, were the maximum which such assets could reasonably be expected to have for some time to come. So, on December 30, 1920, the company wound up the affair by distributing 7,268 shares of the common stock of the Pennsylvania Sugar Refining Company to the contributors to the fund in full satisfaction and discharge of their interest in the Segal matters.

Samuel F. Houston received, ostensibly for his portion, 548.734 shares. Of this block of stock, 222 shares represented his personal proportion. The remaining shares he turned over to his relatives, under the arrangement between them, in satisfaction of their participation in his subscription.

It is not disputed that the market value of the common stock of the Pennsylvania Sugar Refining Company as of December, 1920, and the early part of 1921 was $150 per share.

In computing his taxable income for the year 1920 Samuel F. Houston deducted $33,300, the value of the 222 shares of the Pennsylvania Sugar Refining Company he had received, from $305,000, the amount of his personal contribution in 1906, and thus determined for himself and deducted a loss of $271,700. This loss was allowed by a field agent, but later disallowed by the commissioner, who, on a redetermination based on the disallowance, found a deficiency and accordingly assessed against him an additional tax in the sum of $191,830.53. This is the tax which, after approval by the Board of Tax Appeals, is here for correction on the taxpayer's petition.

In order to decide whether the Board of Tax Appeals was right or wrong in approving the commissioner's disallowance of the deduction, we must first determine whether the taxpayer's admitted loss was a deductible loss under the law; and if so, next, whether it was sustained in the taxable year 1920.

The applicable law is section 214 (a) of the revenue act of 1918, 40 Stat. 1057, which provides:

"That in computing net income there shall be allowed as deductions: * * *

"(5) Losses * * * incurred in any transaction entered into for profit, * * *;"

The Board of Tax Appeals in approving the commissioner did not pass upon the question whether the taxpayer sustained a loss deductible (at some time or other) because incurred "in a transaction entered into for profit." The commissioner, however, based the decision specifically on a finding that "no deductible loss was incurred" at any time and this, we gather from his brief, because of a claimed absence of the element of "profit" in the "transaction."

As to the character of the transaction, the evidence establishes beyond question that it was entered for profit. In announcing this decision we shall not recite the evidence. It will be enough to say that the original agreement shows that interest, dividends and at least litigious profits were expected to accrue from the Segal matters; that the contributors to the fund, after the capial and surplus of the

company had been made whole, "should receive from the company any excess over said amount"; that by the contemporaneous conduct of the parties, as well as by their testimony, it appears that profits were expected from suits and other sources, and, if realized beyond a fixed sum, should go to the contributors. These were not the views of "incorrigible optimists," but of business and professional men, who expected a substantial, indeed, a very large, recovery in the antitrust suit against the American Sugar Refining Company. That their expectation failed of full realization does not destroy the element of contemplated profits or disturb the contractual undertakings of the parties with respect to them or otherwise change the character of the transaction at the time it was entered into. The character of the transaction at the time it was "entered into" continued throughout and controls. The commissioner, however, arguing that Samuel F. Houston and the other contributors did not enter into the transaction for profit, points to the receiver's plan submitted to the stockholders of the trust company, in which there was an appeal "to the duty and honor" of the directors as trusted representatives of the stockholders, intimating a legal liability on their part, and maintains that in making up the guaranty fund the directors acted solely through a sense of honor. Honor and business are not incompatible. A sense of honor arising from the trust reposed in them might have actuated them rather than the expectation of financial gain, yet the fact remains that the transaction was capable of yielding profits and the parties contracted in respect to them.

We hold that the loss which the taxpayer deducted in his income-tax return was at some time a loss deductible under the law.

Was the loss sustained before the applicable revenue act?

The same provision of the revenue act of 1918, supra, allowing deductions in computing net income provided (transposing the language) that a deduction of "losses * * * incurred in any transaction entered into for profit" if "sustained during the taxable year" shall be allowed. The commissioner, conceding, as he must, that the taxpayer sustained a loss at some time, says it was incurred in 1906, when the trust company failed and he and the other directors contributed their money. This contention is based
101 on two theories; one that the payments were not made in a business transaction or in a transaction involving profit, already discussed, but were "contributed" by the directors for their honor's sake so as to save the institution with which their names were connected, and that they lost their money the instant they made their contributions. Of course, if the contributions were gratuitous, that would be true, and it would be true without regard to the motives of the contributors. But we have found that the transaction was "entered into for profit." If that be right, certainly the failure to realize profits in the future can not establish a loss at the beginning any more than can a loss in an ordinary investment disclosed by an after event be held to have been sustained when, years before, the

unwise or unfortunate investment was entered into. Such a ruling would, if followed, overturn thousands of tax payments.

The commissioner's other theory of his contention that the loss was suffered in 1906 is that even though there be some possibility of recoupment, which in this instance eventuated, the loss must be charged to the year in which it was actually suffered under the principle announced in United States v. S. S. White Dental Mfg. Co., 274 U. S. 398. We accept the legal proposition and yield, of course, to the cited principle of law but find that neither is applicable to the instant case. In the White Dental Mfg. Co. case, where the German Government had sequestered that company's property, the loss was suffered not at the beginning of a business transaction but in the course of war, and although the owner of the property later recovered a part of its value in one way and another, the transaction was closed and the loss incurred when the capture was made. In the instant case the transaction was not closed when the contributions were made. It was only begun. What would happen—whether losses would be suffered or profits gained—depended entirely on the liquidation of the Segal matters in the years to come and it was to permit that liquidation in an orderly way that the contributions were made.

We hold that the taxpayer's loss was not sustained in 1906.

When was it sustained?

Finally, the commissioner says—and this is the specific reason which the Board of Tax Appeals gave for approving his action—that the taxpayer has failed to prove, as he was bound to do, any loss subsequent to March 1, 1913, by failing to prove the value of the taxpayer's rights in the Segal matters on that date.

The petitioning taxpayer says that his loss was sustained in the taxable year 1920 as that was the year in which, for the first time, the loss could, in the circumstances of this case, be determined, and that it could be determined then only by finding the difference between the value of what was received and the cost of his rights in the Segal matters.

The commissioner's contention is based on the wording of like provisions in various revenue acts (here Section 202 (a) (1) of the act of 1918) and on their judicial interpretation to the effect that the loss, if any, is the difference between what was ultimately received for the rights in 1920 and their cost in 1906, or their value on March 1, 1913, whichever was lower. Goodrich v. United States, 255 U. S. 727; Walsh v. Brewster, 255 U. S. 536; United States v. Flannery, 268 U. S. 98; McCaughn v. Ludington, 268 U. S. 106; Ayer v. Blair, 26 Fed. (2d) 547.

The petitioner does not question the law of those cases which is in effect that a loss in an ordinary transaction relating to property owned outright by the taxpayer and entered into before March 1, 1913, is determined by adopting either the value as of that date or
102 the cost at the earlier date, whichever is lower, as a basis, but

he maintains that all those cases deal with property having a readily ascertainable value such as real estate, instruments evidencing debt and the like, which is different from ascertaining a loss under a right of the character here involved where the result of the venture could not be known until the Segal matters had been liquidated and where, therefore, the loss of a guarantor, or the value of his correlative right to reimbursement, is not ascertainable until the guaranty transaction is liquidated and where, until then, no ascertainable loss had occurred.

To work out this aspect of the question it will be necessary to determine generally the interest of the contributors, and particularly the petitioner's interest in the Segal matters. It is, because of their nature, difficult to give them a legal definition. Speaking of them in the singular number, it is certain that the petitioning contributor had no legal interest in the Segal securities or matters, or any legal claim to them. Legal title and the right fully to dispose of them was exclusively in the trust company. The petitioner had, however, a right to a share of the residue of the proceeds of their liquidation, whether in cash or its equivalent. That right was in the nature of a chose in action, yet a very restricted chose in action which he could not enforce until liquidation of the Segal matters had been fully completed, whenever that should be. The right, being a chose in action, was property. Being property, it was subject to disposition through testacy, intestacy, and sale, which, so far as the record shows, did not occur in any instance. Being a right in property, it had a value, potential at least, and a value varying perhaps in mental contemplation, which persisted throughout the fourteen years it was held. Confessedly, it had, after the beginning and throughout that period, no market value, for there were no sales. Nor did it conceivably have an ascertainable intrinsic value. Therefore it had no calculable tax value. The value of the right immediately after the beginning and to the very end depended on what the trust company had done with the Segal matters, what it was doing with them and what it would do with them in the future, and, finally, what in the future would be the outcome. To determine, in view of these variable factors, or lack of factors, its true or approximate value on a given date, as that of March 1, 1913, selected by the commissioner as the basis of the tax calculation, was a sheer impossibility. The only fixed factors in the situation were those of cost in 1906 and return in 1920. It follows that the proper basis for measuring the petitioner's admitted loss—because the only possible basis—was that of cost and return. While, by force of statute and judicial decisions, March 1, 1913, is, in given instances, a critical date in computing income taxes, it is not in every instance a controlling date. If in this case the taxpayer had claimed a loss in 1913 on this transaction, he would, without doubt, have been met by the commissioner's ruling and the decision of the Board of Tax Appeals that he was anticipat-

ing a loss because the transaction was not closed; while on the other hand if the taxpayer had, after March 1, 1913, sold his right in the Segal matters at a figure which showed a profit over cost in 1906, though its value on March 1, 1913, could not be ascertained, the Government would, we surmise, have exacted a tax on the profit. This is not an exaggerated illustration, for if the recovery from the American Sugar Refining Company had been for the $10,000,000 demanded, there would have been profits—indeed very large profits—coming to the contributors to the guaranty fund.

We are constrained to hold that the petitioner suffered a
103 deductible loss, that it was sustained by him in 1920, and that the amount of the loss was properly determined by him to be the difference between his subscription to the guaranty fund in 1906—cost—and the value of his pro-rata share of the proceeds of that fund when received by him in 1920.

The order of redetermination made by the United States Board of Tax Appeals is reversed, the additional tax determined by the commissioner set aside, and the income-tax return of the petitioner, in so far as it is affected by the claim deduction here in question, approved.

A true copy. Teste:

_____,

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

104 In United States Circuit Court of Appeals for the Third Circuit

No. 4210 (list No. 129). October term, 1929

SAMUEL F. HOUSTON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Judgment

Filed March 14, 1930

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed, with the direction to the said Board of Tax Appeals to set aside the additional tax determined by the commissioner and to approve the in-

come-tax return of the petitioner in so far as it is affected by the claimed deduction here in question.

Philadelphia, March 14, 1930.

VICTOR B. WOOLLEY,
Circuit Judge.

[Filed indorsement omitted.]

105 [Clerk's certificate to foregoing transcript omitted in printing.]

106 Supreme Court of the United States

Order allowing certiorari

Filed October 13, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] File No. 35121. U. S. Circuit Court of Appeals, Third Circuit. Term No. 199. Robert H. Lucas, Commissioner of Internal Revenue, petitioner, vs. Samuel F. Houston, petition for a writ of certiorari and exhibit thereto. Filed June 14, 1930. File No. 35121.

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No. 199

In the Supreme Court of the United States

OCTOBER TERM, 1930

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SAMUEL F. HOUSTON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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118378—30——1

In the Supreme Court of the United States

OCTOBER TERM, 1930

No. ——

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SAMUEL F. HOUSTON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on March 14, 1930 (R. 101), reversing the decision of the United States Board of Tax Appeals. (R. 25–28.)

STATEMENT

This case reached the Circuit Court of Appeals for the Third Circuit on the petition of Samuel F. Houston, respondent herein, for a review of the

decision of the Board of Tax Appeals determining a deficiency in respondent's income tax for the calendar year 1920.

The facts as found by the Board of Tax Appeals are as follows (R. 18–24):

The respondent was a stockholder and director of the Real Estate Trust Company of Philadelphia, a banking institution. The Trust Company closed its doors in the year 1906, and on August 28, of that year, George H. Earle, Jr., was appointed receiver. The financial embarrassment of the Trust Company was brought about by the improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to one Adolph Segal, and took therefor collateral which could not be easily liquidated, but which was not without value.

The receiver for the Trust Company evolved a plan for reorganization which included as one of its provisions the creation of a fund of $2,500,000 from subscriptions by directors of the company. The company was to be given the $2,500,000 outright, and the subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal Matters." This plan of reorganization became effective, and the subscribers to the $2,500,000 fund made their subscriptions with the understanding that if, from the administration of the "Segal Matters," $3,000,000 should be realized, the subscribers were to receive any excess over this amount which might be realized from the same. No restrictions or time limits

were placed upon the Trust Company in regard to its administration and final disposition of the assets available to the Trust Company in the "Segal Matters."

The Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal Matters" were administered exclusively by it under the direction of George H. Earle, Jr., formerly receiver and thereafter president of the company.

The respondent contributed $755,000 to the fund. Of this amount he contributed $305,000 personally, and the balance was contributed on behalf of his mother and his sisters.

The respondent, at the time he subscribed to the guaranty fund, believed that the "Segal Matters" had considerable potential value, which, under Earle's administration, could be converted into a sufficient amount of cash to repay the subscribers the amount of their subscriptions with interest, and possibly some profit in addition. A suit against the American Sugar Refining Company under the Sherman Antitrust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company, and the value of the "Segal Matters" depended to some extent upon the successful prosecution of such a suit. Suits were brought for $10,000,000, and in January, 1910, the litigation was compromised upon the delivery to the Trust Company, by the American Sugar Refining Company, of certain

bonds wrongfully withdrawn from the Trust Company, among which were bonds of the Pennsylvania Sugar Refining Company. The Trust Company afterwards converted the latter bonds, through a foreclosure, into 7,268 shares of stock in a reorganized company, thereafter called the Pennsylvania Sugar Company. This was on or before January 22, 1912.

Some question arose between the parties in regard to their rights under the subscription agreement, including the right to interest, and on May 5, 1916, a supplemental agreement was entered into. At this time, and for some time prior thereto, the principal unliquidated asset of the original "Segal Matters" was the 7,268 shares of stock in the Pennsylvania Sugar Company, and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds.

In the latter part of 1920, the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service, and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Whereupon, the subscribers, either individually or by their duly constituted representatives, entered into separate agreements which as a group provided for complete liquidation of the "Segal Matters" by the

Trust Company. Distribution of one-fourth of the 7,268 shares of the Pennsylvania Sugar Company stock was made to the subscribers to the fund in proportion to the amount of their subscriptions in full satisfaction and discharge of their interest in the "Segal Matters." The subscribers never received any other return on their subscriptions.

The respondent entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of Pennsylvania Sugar Company stock. He personally was entitled to 222 of these shares. The remaining shares he received as the agent for his sisters and others who had subscribed through him.

At the time of such distribution, each share of stock of the Pennsylvania Sugar Company had a fair market value of $150.

At the end of 1920, the respondent wrote off his books as a loss $271,700, computed by deducting the value of the stock which he received from $305,000, the amount of his subscription. In reporting his income for 1920, he deducted this amount as a loss.

The Commissioner of Internal Revenue disallowed the deduction and found a deficiency in tax of $191,830.53. The respondent appealed to the Board of Tax Appeals. The Board sustained the action of the Commisioner, holding that the loss, if any, would be the difference between what was received in 1920 for the property right and its cost

or March 1, 1913, value, whichever was lower, and that since no effort was made by the respondent to show the March 1, 1913, value of the right in question, no deductible loss was established. The respondent filed a petition with the Circuit Court of Appeals for the Third Circuit, for a review of the decision of the Board (R. 28), and on March 14, 1930, the Circuit Court of Appeals reversed the Board's decision, on the ground that the respondent's loss was the difference between the cost of the right in 1906 and the amount realized in 1920. (R. 94–101.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred—

1. In failing to hold that only those losses are deductible from gross income which are sustained after March 1, 1913;

2. In failing to hold that the ascertainment of the March 1, 1913, value was necessary for the purpose of apportioning the total loss between the periods before and after March 1, 1913;

3. In holding that the deductible loss was the difference between the cost of the taxpayer's property right in 1906 and the amount realized in 1920, there being no evidence that any portion of said loss had been sustained subsequent to March 1, 1913;

4. In failing to hold that the burden was upon the respondent to prove the March 1, 1913, value of

his property right to support a claim for a deductible loss;

5. In holding that under the facts in this case respondent was relieved of the necessity of establishing the March 1, 1913, value of his property right.

REASONS FOR GRANTING THE WRIT

1. The decision in the present case is in conflict with the decisions of this Court.

In *United States* v. *Flannery*, 268 U. S. 98, this Court held that March 1, 1913, is a controlling date because the statutory provisions regarding value on that date are a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible. In this case the lower court imposed no such limitation. It allowed all losses subsequent to 1906 to be deducted even though there was evidence to indicate that a substantial part of the loss had been sustained prior to 1913. (R. 86.)

In *Lucas* v. *Alexander*, 279 U. S. 573, this Court held that the purpose of ascertaining the March 1, 1913, value of property is to apportion the total gain which has accrued between the periods before and after March 1, 1913. Under the *Flannery* decision the same rule is applicable to losses.

In *Reinecke* v. *Spalding*, 280 U. S. 227, this Court held that the burden was upon the taxpayer to establish his right to a deduction disallowed by the Commissioner of Internal Revenue. The respond-

ent presented no evidence of the value of his right on March 1, 1913.

2. The decision in the present case is in conflict with the decisions of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair*, 26 F. (2d) 547, and the Circuit Court of Appeals for the Eighth Circuit in *Holmquist* v. *Blair*, 35 F. (2d) 10.

In *Ayer* v. *Blair, supra*, a taxpayer advanced moneys to an insolvent corporation in 1908, and obtained a partial recoupment in 1920. The court held that the only loss deduction that the taxpayer could have in 1920 was the difference between the 1913 and the 1920 values of his claim to recoupment.

In *Holmquist* v. *Blair, supra*, the court held that the March 1, 1913, value of the taxpayer's property interests was a matter of evidentiary proof, and that, to show error on the part of the Commissioner of Internal Revenue, value on that date must be proved.

3. The question is of present importance in the administration of the tax laws. The Revenue Act of 1924 and subsequent Acts provide a different basis for measuring gains or losses on the sale or other disposition of property acquired prior to March 1, 1913, but the necessity of establishing value as of that date has not been removed.

Wherefore it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

JUNE, 1930.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 94) is reported in 39 F. (2d) 351. The findings of fact and the opinion of the Board of Tax Appeals (R. 18–27) are reported in 13 B. T. A. 279.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 14, 1930. (R. 101.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Was it incumbent upon the respondent to establish the March 1, 1913, value of his property right acquired prior to that date, to support a claim for a deductible loss on the disposition of such property in 1920?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat 1057, 1060, 1066, 1067,—

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year and not compensated for by insurance

or otherwise, if incurred in any transaction entered into for profit, * * *.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

Treasury Department Regulations 45 (1920 edition) as amended by Treasury Decision 3206, Cum. Bul. No. 5, July–December, 1921, p. 51—

ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or ex-

> changed (a) at more than cost but at less than its fair market value as of March 1, 1913, or (b) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made for any depreciation or depletion sustained. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. * * *.

STATEMENT

The facts are stated in the petition for certiorari.

ARGUMENT

I

The Circuit Court of Appeals holds that the proper basis for measuring the respondent's loss was the difference between cost in 1906 and the amount realized in 1920, and in support of this view states (R. 100):

> While by force of statute and judicial decisions, March 1, 1913, is, in given instances, a critical date in computing income taxes, it is not in every instance a controlling date.

It is submitted that the ascertainment of the March 1, 1913, value of the property in question was necessary in order to apportion the total loss sustained between the periods before and after March 1, 1913. In *Lucas* v. *Alexander*, 279 U. S. 573, this Court said (p. 579):

> The purpose of ascertaining the value of the taxpayer's property on March 1, 1913, is, as Section 202 states, to measure that part of his total gain which has arisen or accrued after the enactment of any of the statutes taxing income and thus to arrive at his gain which may be taxed as income. *Lynch* v. *Turrish* [247 U. S. 221]. Value as of that date may be disregarded unless it serves that purpose. *United States* v. *Flannery,* 268 U. S. 98; *Goodrich* v. *Edwards,* 255 U. S. 527; *Walsh* v. *Brewster,* 255 U. S. 536.

And on page 580:

> Here, 1913 value is at most merely a method of allocating a known income to the periods in which it actually accrued. It is never necessary to speculate, as did the court below, as to what might later be realized from his property by the taxpayer, nor as to what might have been realized if, on March 1, 1913, he had made some forced disposition of the property which would have precluded any taxable gain. For the necessity of ascertaining value as of March 1, 1913, can never arise until some later date when income has been produced by converting the property into money or money's worth and the amount actually realized is known, and then, as we have said, only for the purpose of apportioning the total gain which has accrued between the periods before and after March 1, 1913.

Authority for applying the same rule to losses is found in *United States* v. *Flannery*, 268 U. S. 98, where this Court said (p. 103):

> These decisions [*Goodrich* v. *Edwards*, and *Walsh* v. *Brewster*] are equally applicable to the Act of 1918. * * * As it was held in these decisions that the Act of 1916 imposed a tax to the extent only that gains were derived from the sale, and that the provision as to the market value of the property on March 1, 1913, was applicable only where a gain had been realized over the original capital investment, so we think it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that an actual gain was derived or an actual loss sustained from the investment, and that the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible.

The respondent, by making his contribution in 1906, acquired a right to share in the excess proceeds from the liquidation of the "Segal Matters"; this right was property in the nature of a chose in action; it was subject, as the lower court has said (R. 100), "to disposition through testacy, intestacy, and sale"; and it had a value which persisted throughout the fourteen years it had been held. In 1920, he converted this right into "money

or money's worth" having a value less than cost. Hence, if the amount realized was in excess of the March 1, 1913 value, no loss could be deducted, for the reason that the loss would be attributed to the period prior to March 1, 1913; or, if the March 1, 1913 value was less than cost but more than the amount realized, the deductible loss would be the excess of the March 1, 1913 value over the amount realized, for the reason that the loss attributable to the period prior to March 1, 1913, is not dedeductible. The basis used by the lower court to measure the loss in the instant case ignores the statutory limitation upon the amount of the actual loss which is deductible, and results in the erroneous allowance of a loss which may have been sustained prior to March 1, 1913.

II

The burden was upon the respondent to prove that he was entitled to the deduction disallowed by the Commissioner. *Reinecke* v. *Spalding*, 280 U. S. 227. It was necessary that respondent establish the March 1, 1913, value of his right in order to measure the loss sustained after that date. The respondent, however, relied upon a different basis for measuring the amount of his loss, and made no effort to show the value of his right on March 1, 1913. Difficulty in establishing such value did not relieve respondent of his burden. Cf. *Lucas* v. *Alexander*, *supra*, p. 579.

CONCLUSION

Because of the importance of the question involved in the administration of the tax laws and the conflict of decisions thereon, it is submitted that the petition should be granted.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
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JUNE, 1930.

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No. 199

In the Supreme Court of the United States

OCTOBER TERM, 1930

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SAMUEL F. HOUSTON

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

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No. 199

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SAMUEL F. HOUSTON

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 56) is reported in 39 F. (2d) 351. The findings of fact and the opinion of the Board of Tax Appeals (R. 9–16) are reported in 13 B. T. A. 279.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 14, 1930. (R. 63.) Petition for certiorari was filed in this Court on June 14,

1930, and was granted October 13, 1930. (R. 64.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Was it incumbent upon the respondent to establish the March 1, 1913, value of his property right acquired prior to that date, to support a claim for a deductible loss on the disposition of such property in 1920?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are printed in the Appendix, *infra*, pp. 18–20.

STATEMENT

This case reached the Circuit Court of Appeals for the Third Circuit in the petition of Samuel F. Houston, respondent herein, for a review of the decision of the Board of Tax Appeals determining a deficiency in respondent's income tax for the calendar year 1920.

The facts as found by the Board of Tax Appeals are as follows (R. 10–14):

The respondent was a stockholder and director of the Real Estate Trust Company of Philadelphia, a banking institution. The Trust Company closed its doors in the year 1906, and on August 28 of that year George H. Earle, Jr., was appointed receiver. The financial embarrassment of the Trust Com-

pany was brought about by the improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to one Adolph Segal, and took therefor collateral which could not be easily liquidated, but which was not without value.

The receiver for the Trust Company evolved a plan for reorganization which included as one of its provisions the creation of a fund of $2,500,000 from subscriptions by directors of the company. The company was to be given the $2,500,000 outright, and the subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal Matters." This plan of reorganization became effective, and the subscribers to the $2,500,000 fund made their subscriptions with the understanding that if, from the administration of the "Segal Matters," $3,000,000 should be realized, the subscribers were to receive any excess over this amount which might be realized from the same. No restrictions or time limits were placed upon the Trust Company in regard to its administration and final disposition of the assets available to the Trust Company in the "Segal Matters."

The Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal Matters" were administered exclusively by it under the direction of George H. Earle, Jr., formerly receiver and thereafter president of the company.

The respondent contributed $755,000 to the fund. Of this amount he contributed $305,000 personally, and the balance was contributed on behalf of his mother and his sisters.

The respondent, at the time he subscribed to the guaranty fund, believed that the "Segal Matters" had considerable potential value, which, under Earle's administration, could be converted into a sufficient amount of cash to repay the subscribers the amount of their subscriptions with interest, and possibly some profit in addition. A suit against the American Sugar Refining Company under the Sherman Antitrust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company, and the value of the "Segal Matters" depended to some extent upon the successful prosecution of such a suit. Suits were brought for $10,000,000, and in January, 1910, the litigation was compromised upon the delivery to the Trust Company, by the American Sugar Refining Company, of certain bonds wrongfully withdrawn from the Trust Company, among which were bonds of the Pennsylvania Sugar Refining Company. The Trust Company afterwards converted the latter bonds, through a foreclosure, into 7,268 shares of stock in a reorganized company, thereafter called the Pennsylvania Sugar Company. This was on or before January 22, 1912.

Some question arose between the parties in regard to their rights under the subscription agreement, including the right to interest, and on May

5, 1916, a supplemental agreement was entered into. At this time, and for some time prior thereto, the principal unliquidated asset of the original "Segal Matters" was the 7,268 shares of stock in the Pennsylvania Sugar Company, and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds.

In the latter part of 1920 the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service, and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Thereupon the subscribers, either individually or by their duly constituted representatives, entered into separate agreements which as a group provided for complete liquidation of the "Segal Matters" by the Trust Company. Distribution of one-fourth of the 7,268 shares of the Pennsylvania Sugar Company stock was made to the subscribers to the fund in proportion to the amount of their subscriptions in full satisfaction and discharge of their interest in the "Segal Matters." The subscribers never received any other return on their subscriptions.

The respondent entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of Pennsylvania Sugar Company stock. He personally was entitled to 222 of these

shares. The remaining shares he received as the agent for his sisters and others who had subscribed through him.

At the time of such distribution each share of stock of the Pennsylvania Sugar Company had a fair market value of $150.

At the end of 1920 the respondent wrote off his books as a loss $271,700, computed by deducting the value of the stock which he received from $305,000, the amount of his subscription. In reporting his income for 1920, he deducted this amount as a loss.

The Commissioner of Internal Revenue disallowed the deduction and found a deficiency in tax of $191,830.53. The respondent appealed to the Board of Tax Appeals. The Board sustained the action of the Commissioner, holding that the loss, if any, would be the difference between what was received in 1920 for the property right and its cost or March 1, 1913, value, whichever was lower, and that since no effort was made by the respondent to show the March 1, 1913, value of the right in question, no deductible loss was established. The respondent filed a petition with the Circuit Court of Appeals for the Third Circuit, for a review of the decision of the Board (R. 16), and on March 14, 1930, the Circuit Court of Appeals reversed the Board's decision, on the ground that the respondent's loss was the difference between the cost of the right in 1906 and the amount realized in 1920 (R. 56–63).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred—

1. In failing to hold that only those losses are deductible from gross income which are sustained after March 1, 1913;

2. In failing to hold that the ascertainment of the March 1, 1913, value was necessary for the purpose of apportioning the total loss between the periods before and after March 1, 1913;

3. In holding that the deductible loss was the difference between the cost of the taxpayer's property right in 1906 and the amount realized in 1920, there being no evidence that any portion of said loss had been sustained subsequent to March 1, 1913;

4. In failing to hold that the burden was upon the respondent to prove the March 1, 1913, value of his property right to support a claim for a deductible loss;

5. In holding that under the facts in this case respondent was relieved of the necessity of establishing the March 1, 1913, value of his property right.

SUMMARY OF ARGUMENT

The respondent is entitled to deduct only the loss which accrued after March 1, 1913. Section 202 of the Revenue Act of 1918 expressly provides that the basis for determining loss on the sale of property acquired before March 1, 1913, shall be "the fair market price or value of such property

as of that date." The decisions of this Court establish that when property acquired before March 1, 1913, is sold after that date the basis for determining loss is the cost price, or the value on March 1, 1913, whichever is lower. A determination of the March 1, 1913, value of the respondent's property is, therefore, an essential prerequisite to the determination of a deductible loss.

The burden of proving the March 1, 1913, value was on the respondent. The respondent made no effort to establish the value of his right on that date and consequently failed to meet the burden. Furthermore, the record affirmatively shows that the respondent's property had no value on March 1, 1913, and that all the loss incurred by him accrued prior to that date.

ARGUMENT

I

THE RESPONDENT IS ENTITLED TO DEDUCT ONLY THE LOSS WHICH ACCRUED AFTER MARCH 1, 1913

The Circuit Court of Appeals held that the respondent in 1906 entered into a transaction for profit as a result of which he acquired certain property interests; that he disposed of those interests in 1920 at less than the cost; and that he is entitled to deduct for tax purposes the entire difference between his 1906 cost and his 1920 receipts, even though the value of his interests on March 1, 1913, was not determined. We contend that the decision

is erroneous because it fails to recognize that the respondent could deduct only that portion of his loss which he incurred subsequent to March 1, 1913, and that, consequently, the ascertainment of the March 1, 1913, value of his property was necessary in order to determine the amount of the loss which had occurred subsequent to that time.

The taxpayer must find in the statute the authority for taking a deduction. See *Anderson* v. *Forty-Two Broadway Co.*, 239 U. S. 69. In the present case the statute is explicit and by its terms requires that only the difference between the selling price and the value of the property on March 1, 1913, may be deducted as a loss. Section 202 (a) (1) of the Revenue Act of 1918 (*infra*, p. 18) provides—

> That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; * * *

Article 1561 of Regulations 45, as amended by Treasury Decision 3206 (*infra*, pp. 19–20), promulgated under this section applies to the present situation directly. That article provided that—

> in the case of property acquired before March 1, 1913, when its fair market value as

> of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor.

This Court has had occasion to consider this provision of the Revenue Act of 1918, or the similar provisions of earlier statutes in several cases. In *Goodrich* v. *Edwards*, 255 U. S. 527, which arose under the Revenue Act of 1916, it appeared that property was sold in 1916 for less than it had cost in 1912 but for more than its value on March 1, 1913. This Court held that "since no gain was realized on this investment by the plaintiff in error no tax should have been assessed against him." In *Walsh* v. *Brewster*, 255 U. S. 536, it was held that when the cost price was greater than the value on March 1, 1913, the taxable income on a sale after that date at an actual profit was the excess of the sale price over the cost price.

In *United States* v. *Flannery*, 268 U. S. 98, it was held that these decisions were applicable to losses as well as to gains. This Court said (p. 103):

> These decisions are equally applicable to the Act of 1918 * * *. As it was held in these decisions that the Act of 1916 imposed a tax to the extent only that gains were derived from the sale, and that the provision as to the market value of the property on March 1, 1913, was applicable only where a gain had been realized over the original capital investment, so we think it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that

> an actual gain was derived or an actual loss sustained from the investment, and that the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that *this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible.* (Italics ours.)

In *Heiner* v. *Tindle*, 276 U. S. 582, it appeared that in 1901 the taxpayer leased property which had formerly been his residence, thus devoting the property to a transaction entered into for profit. The property was sold in 1920 for a sum considerably less than its value on March 1, 1913. The value of the property in 1901 did not appear. The taxpayer sought to deduct the difference between the March 1, 1913 value and the selling price as a loss, but this Court held (p. 587):

> The cause should be remanded for a new trial so that the value of the property as of October 1, 1901, when rented, may be found. If that value is larger than the value of March 1, 1913, the deduction made below should be allowed; if less, only the difference, if any, between its then value and the sale price should be allowed.

This Court thus directed that when the cost was greater than the March 1, 1913, value, the latter value should be taken as the basis for deducting a loss.

We believe that these decisions establish the rule that under the Revenue Act of 1918 the basis for determining loss arising from the sale of property acquired before March 1, 1913, is the cost or the value on March 1, 1913, whichever is lower. Although there is apparently no decision of this Court in which it appeared that the March 1, 1913, value was lower than the cost price, this situation is expressly covered by the precise terms of the statute. The Circuit Courts of Appeals, other than the court below, have uniformly held that when the value on March 1, 1913, is less than the cost, only the difference between the March 1, 1913, value and the sale price may be deducted as a loss. *Ayer* v. *Blair*, 26 F. (2d) 547 (Ct. of App. D. C.); *Nichols* v. *Smith*, 35 F. (2d) 938 (C. C. A. 1st); *Bloch* v. *Commissioner*, 42 F. (2d) 1013 (C. C. A. 4th), affirming *per curiam*, 16 B. T. A. 425. See also *Holmquist* v. *Blair*, 35 F. (2d) 10 (C. C. A. 8th).[1]

In the case at bar the respondent, by making his contribution in 1906, acquired a right to share in the excess proceeds from the liquidation of the "Segal Matters"; this right was property in the nature of a chose in action; it was subject, as the lower court has said (R. 62), "to disposition through testacy, intestacy, and sale." In 1920 he

[1] See also the opinion of the Attorney General to the Secretary of the Treasury in 33 Op. Atty. Gen. 291, 297, where it was held that—

"No taxable gain or allowable loss resulted if the selling price was greater than the value of the property on March 1, 1913, but less than the cost thereof."

converted his right into "money or money's worth" having a value less than cost, and he suffered thereby an actual loss. If the amount which he finally realized was in excess of the March 1, 1913, value of his property no loss may be deducted for the reason that all of the loss would then be attributable to the period prior to March 1, 1913. If the March 1, 1913, value was less than the 1906 cost but more than the amount realized the deductible loss would be the excess of the March 1, 1913, value over the amount realized, that being the only portion of the loss attributable to the period subsequent to March 1, 1913. A determination of the March 1, 1913, value of respondent's property is therefore an essential prerequisite to the determination of a deductible loss. The basis used by the lower court ignores the statutory limitation upon the amount of the actual loss which is deductible and results in the allowance of a loss which may have been sustained either partially or wholly prior to March 1, 1913.

II

THE RESPONDENT FAILED TO MEET THE BURDEN OF PROVING THE MARCH 1, 1913, VALUE

The court below states that to determine the true or approximate value of the property in question on March 1, 1913, was a "sheer impossibility" because such property had no fair market value, no ascertainable intrinsic value, and no calculable tax

value. (R. 62.) This conclusion is unwarranted. We believe that the record affirmatively shows that respondent's property right had no value on March 1, 1913. In any event the value on that date, if any, was reasonably determinable. On March 1, 1913, the principal unliquidated asset of the original "Segal Matters" was 7,268 shares of stock in the Pennsylvania Sugar Company. The record does not disclose what the other "Segal Matters" were in addition to this stock, but it is evident that such securities were of minor importance and value. (R. 13, 48, 50–51, 52, 58.) Full information as to the securities other than the stock was available to respondent in the form of a statement by the trust officer of the Trust Company (R. 47), but such statement was not made a part of the record. The assumption is justified therefore that on March 1, 1913, the only unliquidated asset in which the respondent and his associates were materially interested was the 7,268 shares of stock in the Pennsylvania Sugar Company. The value of that stock in 1920 was stipulated to be $150 per share. (R. 22.) No reason appears why its value as of the earlier date of March 1, 1913, could not have been reasonably determined and the value of respondent's contingent right therein, if any, established. In *Heiner* v. *Tindle, supra,* this Court remanded the cause for a new trial so that the value of a dwelling house might be found as of the date when taxpayer ceased to oc-

cupy it as a residence and rented it to others, which date was prior to March 1, 1913. The value of the property as of March 1, 1913, was found, and this Court held that the ascertainment of the market value of the property as of the earlier date "would not seem to involve any greater administrative difficulty than the ascertainment of market value on March 1, 1913" (p. 586).

It was necessary, therefore, that respondent establish the March 1, 1913, value of his right in order to measure the loss sustained after that date. The respondent, however, relied upon a different basis for measuring the amount of his loss, and made no effort to show the value of his right on March 1, 1913. Difficulty in establishing such value did not relieve respondent of his burden. *Cf. Lucas* v. *Alexander*, 279 U. S. 573, p. 579; *United States* v. *Ludey*, 274 U. S. 295, 302. He failed to bring himself within the statute or to meet the burden which rested on him to show that he was entitled to the deduction denied him by the Commissioner. *Botany Mills* v. *United States*, 278 U. S. 282; *Reinecke* v. *Spalding*, 280 U. S. 227.

The property right which the respondent had on March 1, 1913, was his share of the excess value of the "Segal Matters" over the then unliquidated balance of the $3,000,000 impaired capital and surplus. On March 1, 1913, the Trust Company had not recouped all of the $3,000,000 impaired capital and surplus to which the proceeds of the administration and sale of the "Segal Matters" were to

be devoted before distribution of any excess. The report of the directors' committee of February 11, 1915, signed by this respondent, discloses that as late as 1915 there remained approximately $1,300,000 of the surplus of the company which had not yet been made whole out of the "Segal Matters." (R. 47.) If the unliquidated surplus amounted to $1,300,000 in 1915 it is obvious that at least that amount was unliquidated on March 1, 1913. On March 1, 1913, therefore, the value of respondent's property right was represented by the difference in the value of the 7,268 shares of the Pennsylvania Sugar Company stock and at least $1,300,000 still due the Trust Company. From the same report (R. 48) it appears that at that time the Pennsylvania Sugar Company stock did not have an actual value sufficient to extinguish the deficiency in the Trust Company's capital and surplus to which it was pledged. The stock would have to have had a value of approximately $179 per share to equal the $1,300,000 it was pledged to cover. As the value of respondent's property right on March 1, 1913, represented only his share of the excess value of this stock over and above the deficiency charged against it, it is fairly inferable that his property right on that date had no value whatever. Therefore none of the loss which respondent sustained accrued after March 1, 1913.

CONCLUSION

The decision of the Circuit Court of Appeals for the Third Circuit should be reversed.

Respectfully submitted.

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FEBRUARY, 1931.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1066, 1067, provides in part as follows:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; * * *.
>
> SEC. 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, * * *.

Treasury Regulations 45, promulgated December 29, 1919, under the Revenue Act of 1918, provided in part as follows:

> ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (a) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (b) if acquired

on or after that date, its cost or its approved inventory value. In both cases proper adjustment must be made for any depreciation or depletion sustained. What the fair market price or value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581–1588. The fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of war profits and excess profits tax. See section 326 and article 831.

Article 1561 of Treasury Regulations 45 (1920 ed.), promulgated January 28, 1921, is the same as Article 1561 of Regulations 45 (1919 ed.) set out above.

Article 1561 of Regulations 45 (1920 ed.) was amended by Treasury Decision 3206, promulgated July 28, 1921, which reads in part as follows:

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF
INTERNAL REVENUE, *Washington, D. C.*

To collectors of internal revenue and others concerned:

Articles * * * 1561 * * * of Regulations No. 45 (1920 ed.) are hereby amended in order that the rule announced by the Supreme Court in the cases of Goodrich v. Edwards and Brewster v. Walsh, respecting the basis for the determination of taxable gain or deductible loss in the case

of property acquired prior to March 1, 1913, and sold or disposed of subsequent thereto, may be incorporated therein. The amendments are merely for the purpose of such incoropration and make no attempt to correct any of the regulations in any respect other than the one necessitated by those cases. The amendments are as follows:

* * * * *

ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or exchanged (a) at more than cost but at less than its fair market value as of March 1, 1913, or (b) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made for any depreciation or depletion sustained. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. As to inventories see section 203 of the statute and articles 1581–1588. The

fair market value as of March 1, 1913, has no bearing on the determination of the invested capital of a corporation for the purpose of the war profits and excess profits tax. See section 326 and article 831.

* * * * *

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 28, 1921.

A. W. MELLON,
Secretary of the Treasury.

U. S. GOVERNMENT PRINTING OFFICE: 1921

FILE COPY

No. 199.

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OCTOBER TERM, 1930.

IN THE

Supreme Court of the United States

ROBERT H. LUCAS, Commissioner of Internal Revenue,
Petitioner,

v.

SAMUEL F. HOUSTON.

IN RE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR SAMUEL F. HOUSTON, Respondent.

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In the Supreme Court of the United States.

OCTOBER TERM, 1930. No. 199.

Robert H. Lucas, Commissioner of Internal Revenue, Petitioner,

v.

Samuel F. Houston.

IN RE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

STATEMENT OF FACTS.

The statement of facts in the petition for the Government, while substantially correct in so far as it goes, omits certain facts which are essential to give a clear picture of the transaction out of which the respondent's loss arose.

A full and more complete statement of the facts is to be found in the opinion of Judge Woolley, for the Circuit Court of Appeals (Record, p. 94), and therefore no restatement of them will be made here.

BRIEF FOR SAMUEL F. HOUSTON, RESPONDENT.

The question as presented by the Government in the brief in support of the petition for writ of certiorari in this case is stated as follows (p. 9):—

> "Was it incumbent upon the respondent to establish the March 1, 1913, value of his property right acquired prior to that date, to support a claim for a deductible loss on the disposition of such property in 1920?"

The draftsman of this statement of the question assumes in it that there was no proof by the respondent of a valuation of the subject matter of the loss, and justifies his assumption in the reasons for granting the writ (pp. 7 and 8), by asserting that "The respondent presented no evidence of the value of his right on March 1, 1913."

The Statement of "Specification of Errors to be Urged" appears to present to this Court, as a reason why the writ should be allowed, that the Court below failed "to hold that only those losses are deductible from gross income which are sustained after March 1, 1913," and thereby permitted the deduction of a loss which had been suffered by the respondent prior to that date. This reason has no foundation in the opinon and judgment of the learned Court below, because the Court expressly found that the loss deducted by the taxpayer was sustained after March 1, 1913, and in the year of 1920, in the return for the income of which the loss was claimed.

The respondent expects to establish to the satisfaction of this Court in the course of the argument hereafter made that the contentions presented on behalf of the Government in support of its petition are unfounded.

In the first instance, however, the respondent suggests that a reading of the opinion of the Circuit Court of Appeals (Record, p. 94) will show that this case is not one of public interest because its peculiar and unusual facts limit

the decision of it to these taxpayers only, and that the general conclusions reached by the learned Circuit Court of Appeals are not in conflict with the decisions of this Court, but are in full accord with them.

The Record in this case shows that the Commissioner made no finding that the loss sustained by the taxpayer was prior to March 1, 1913, but on the contrary, in disallowing the loss the Commissioner made the following statement (Petitioner's Exhibit No. 6—Record, p. 77):

> "In regard to the disallowance of $271,700.00, you are advised that under the provisions of Revenue Act of 1918, no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of and the evidence is to the effect that the stock was still in your possession at the close of the year 1920."

The subsequent rulings of the Department and decisions by the courts made this reason for disallowance insufficient. The Commissioner, as the record shows, shifted his ground on the appeal to the Board of Tax Appeals and asserted other reasons there set forth, including the contention that no loss could be sustained on a value of the "Segal Matters" as of March 1, 1913.

At trial the Commissioner made no effort to establish a March 1, 1913, value at less than the original subscription of the respondent to the guaranty fund in 1906, but not relying upon this failure of the Commissioner to sustain what the respondent then believed to be the Commissioner's burden, the respondent undertook to meet the requirements of the situation in a manner subsequently declared by this Court to be the obligation imposed by the statutes.

In *Reinecke* v. *Spalding*, 280 U. S. 227, this Court said:

> "Under the statute it became necessary for respondent to establish the fair market value of her interest in the mines on March 1, 1913, *or at least that such value was not below what she claimed it was.*"

The record shows that the Respondent clearly established by opinion evidence, which was the only evidence available in the absence of market values, that the value of the Segal assets (the subject matter of the loss claimed), as of March 1, 1913, *was at least a value not below that of original cost in 1906.*

It is to be remembered that the cost of the "Segal Matters" under consideration, as of 1906, is the aggregate of the Guaranty Fund subscribed to by the Respondent, and others, by which they acquired rights in distribution of the proceeds of the "Segal Matters," under the terms and conditions of the agreements which form a part of the record.

It is the difference between the Respondent's original cost and the value of his portion of the assets received in liquidation in 1920 which constituted the loss claimed, and the evidence, to which reference will be made, establishes, by the opinion of those competent to judge the fact, that the "Segal Matters," on March 1, 1913, had an estimated value sufficient to return the original cost and a profit.

It was decided by the parties in interest in 1915, while the "Segal Matters" were still being administered by The Real Estate Trust Company for its own account and as trustee for the subscribers, that an interpretation of the original agreements should be obtained from John G. Johnson, Esq., of Philadelphia, who was counsel for George H. Earle, Receiver, and joint author with him of the plan of reorganization of The Real Estate Trust Company. The opinion of Mr. Johnson was asked for and was rendered under date of July 5th, 1915. (Petitioner's Exhibit 3—Rec., p. 57.)

Mr. Johnson held that the "Segal Matters" were subject to sole administration by The Real Estate Trust Company within its uncontrolled discretion, and that the subscribers to the Guaranty Fund were entitled only to the exercise of an honest administration of ordinary prudence and intelligence and without power to interfere with or direct the manner or time of liquidation.

He further held that when the amount of realization

reached Three million dollars, from whatever source acquired, the right of the Trust Company to any additional payment ceased and the right of the subscribers attached, and thereafter all proceeds from the disposition of Segal assets became the property of the subscribers to the fund.

It is to be remembered that Mr. Johnson's opinion was given while the administration of the "Segal Matters" was continuing and speaks of the future when interpreting the rights of the parties to interest, as well as to a pro rata share in the proceeds realized from liquidation of principal assets.

The conclusion which he reached formed the basis for the subsequent agreement entered into between the parties, Mr. Johnson said (Petitioner's Exhibit No. 3, Rec., p. 62):

> "Interest is to be allowed in case of an excess sufficient in amount; but it is to be allowed only to the contributors upon the amount of their contributions.
>
> "In my judgment, therefore, the contributors are entitled to any excess in the realization of the 'Segal Matters' which will arise after there has been received from the 'Segal Items' by way of proceeds of sale, and income anterior to their conversion, the sum of $3,000,000."

Mr. Johnson also stated that in his opinion the power to administer by the Trust Company exclusively was not limited by any duty to consult with the subscribers or their representatives.

The evidence justifies the conclusion that in 1916, the year in which the Supplemental Agreement was made (Rec., p. 63), the Respondent and the other subscribers had a reasonable expectation of a return of their subscriptions made in 1906, with interest or profit from the "Guaranty Fund:"

The Respondent, Samuel F. Houston, gave the following as his opinion evidence in this connection (Rec., p. 83):—

> "At the time the agreement of 1916 was entered into by me, I was of the opinion that if the Sugar

> Company was as successful as we anticipated and hoped, the much desired result that the Real Estate Trust Company would work out from the Segal assets a sum sufficient to return to the subscribers the amount of their contributions need not be a matter of very long time."
>
> * * * * * * *

There is no reference to this evidence in the Petition or in the Brief for the Government.

The continuing value of the "Segal Matters" equal to the original subscriptions is established for this case not only by this oral testimony produced before the Board, but by the agreement of May 5, 1916, between The Real Estate Trust Company of Philadelphia and the subscribers through their Committee following the opinion of Mr. Johnson, (Petitioner's Exhibit, No. 4, Rec., p. 63), where the whole intent of the agreement between the Trust Company and the subscribers, of whom respondent was one, was to provide for a realization on their subscriptions.

The law does not require, and certainly a taxing law should not be construed to require, proof by mathematical certainty of fact inherently not susceptible of such proof. The equity of a taxpayer, which he by his own act is incapable of reducing to possession and which is dependent upon the uncontrolled administration of someone else, cannot be measured to the last dollar by any known scheme of accounting or the far-reaching theories and rules of the tax gatherer.

In the present case the Respondent in 1906 backed his confidence in the hope of success from his subscription by paying $305,000 into the guaranty fund. This justifiable expectation of profit continued up to and beyond March 1, 1913. There are no facts upon the record to show that as of March 1, 1913, there was not ample foundation for the realization of this expectation.

All that the Respondent was required to prove was that as of March 1, 1913, the rights of the Respondent in the

"Segal Matters" had a value no less than the amount of the original investment in 1906. This was proved as fully as the unusual character of the transaction permits—and no evidence to the contrary was offered by the Commissioner.

The "Segal Matters" had in 1906 an *uncertain value.* This fact is stipulated in the record (p. 36). As of March 1, 1913, they had an equally *uncertain value* but not evidenced to be less than the subscriptions to the Guaranty Fund. The Respondent proved an actual loss of the difference between the subscription to the Guaranty Fund and the value of the securities received in distribution in the sum of $271,700. It would seem that Respondent has sufficiently complied with the mandate of the Statutes, as interpreted by this Court, to sustain the deduction of the loss as claimed.

In passing upon the contention of the Commissioner in the Circuit Court of Appeals upon this question, which is the sole question urged upon this Court, the lower Court disposed of it in language which it might be helpful to repeat here (Opinion, Woolley, Circuit Judge, Record, pp. 99-101):—

> "Finally, the Commissioner says—and this is the specific reason which the Board of Tax Appeals gave for approving his action—that the taxpayer has failed to prove, as he was bound to do, any loss subsequent to March 1, 1913 by failing to prove the value of the taxpayer's rights in the Segal matters on that date.
>
> "The petitioning taxpayer says that his loss was sustained in the taxable year 1920 as that was the year in which, for the first time, the loss could, in the circumstances of this case, be determined, and that it could be determined then only by finding the difference between the value of what was received and the cost of his rights in the Segal matters.
>
> "The Commissioner's contention is based on the wording of like provisions in various revenue acts (here Section 202 (a) (1) of the Act of 1918) and

on their judicial interpretation to the effect that the loss, if any, is the difference between what was ultimately received for the rights in 1920 and their cost in 1906, or their value on March 1, 1913, whichever was lower. Goodrich *v.* United States, 255 U. S. 727; Walsh *v.* Brewster, 255 U. S. 536; United States *v.* Flannery, 268 U. S. 98; McCaughn *v.* Ludington, 268 U. S. 106; Ayer *v.* Blair, 26 Fed. (2d) 547.

"The petitioner does not question the law of those cases which is in effect that a loss in an ordinary transaction relating to property owned outright by the taxpayer and entered into before March 1, 1913 is determined by adopting either the value as of that date or the cost at the earlier date, whichever is lower, as a basis, but he maintains that all those cases deal with property having a readily ascertainable value such as real estate, instruments evidencing debt and the like, which is different from ascertaining a loss under a right of the character here involved where the result of the venture could not be known until the Segal matters had been liquidated and where, therefore, the loss of a guarantor, or the value of his correlative right to reimbursement, is not ascertainable until the guaranty transaction is liquidated and where, until then, no ascertainable loss had occurred.

"To work out this aspect of the question it will be necessary to determine generally the interest of the contributors and particularly the petitioner's interest in the Segal matters. It is, because of their nature, difficult to give them a legal definition. Speaking of them in the singular number, it is certain that the petitioning contributor had no legal interest in the Segal securities or matters, or any legal claim to them. Legal title and the right fully to dispose of them was exclusively in the Trust Company. The petitioner had, however, a right to a share of the residue of the proceeds of their liquidation, whether in cash or its

equivalent. That right was in the nature of a chose in action yet a very restricted chose in action which he could not enforce until liquidation of the Segal matters had been fully completed, whenever that should be. The right, being a chose in action, was property. Being property, it was subject to disposition through testacy, intestacy and sale, which, so far as the record shows, did not occur in any instance. Being a right in property it had a value, potential at least, and a value, varying perhaps in mental contemplation, which persisted throughout the fourteen years it was held. Confessedly, it had, after the beginning and throughout that period, no market value for there were no sales. Nor did it, conceivably, have an ascertainable intrinsic value. Therefore it had no calculable tax value. The value of the right immediately after the beginning and to the very end depended on what the Trust Company had done with the Segal matters, what it was doing with them and what it would do with them in the future, and, finally, what in the future would be the outcome. To determine, in view of these variable factors, or lack of factors, its true or approximate value on a given date, as that of March 1, 1913 selected by the Commissioner as the basis of the tax calculation, was a sheer impossibility. The only fixed factors in the situation were those of cost in 1906 and return in 1920. It follows that the proper basis for measuring the petitioner's admitted loss—because the only possible basis—was that of cost and return. While by force of statute and judicial decisions March 1, 1913 is, in given instances, a critical date in computing income taxes, it is not in every instance a controlling date. If in this case the taxpayer had claimed a loss in 1913 on this transaction, he would, without doubt, have been met by the Commissioner's ruling and the decision of the Board of Tax Appeals that he was anticipating a loss because the transaction was not closed; while on the other

hand if the taxpayer had, after March 1, 1913, sold his right in the Segal matters at a figure which showed a profit over cost in 1906, though its value on March 1, 1913 could not be ascertained, the government would, we surmise, have exacted a tax on the profit. This is not an exaggerated illustration for if the recovery from the American Sugar Refining Company had been for the $10,000,000 demanded there would have been profits—indeed very large profits—coming to the contributors to the guaranty fund.

"We are constrained to hold that the petitioner suffered a deductible loss, that it was sustained by him in 1920 and that the amount of the loss was properly determined by him to be the difference between his subscription to the guaranty fund in 1906—cost—and the value of his pro-rata share of the proceeds of that fund when received by him in 1920."

The argument for the Government in the Circuit Court of Appeals presented several questions which have been abandoned in this petition, and no comment upon them is required other than to suggest that there appears to be no more merit in the sole question supported by the Government's brief than there was in those which were abandoned.

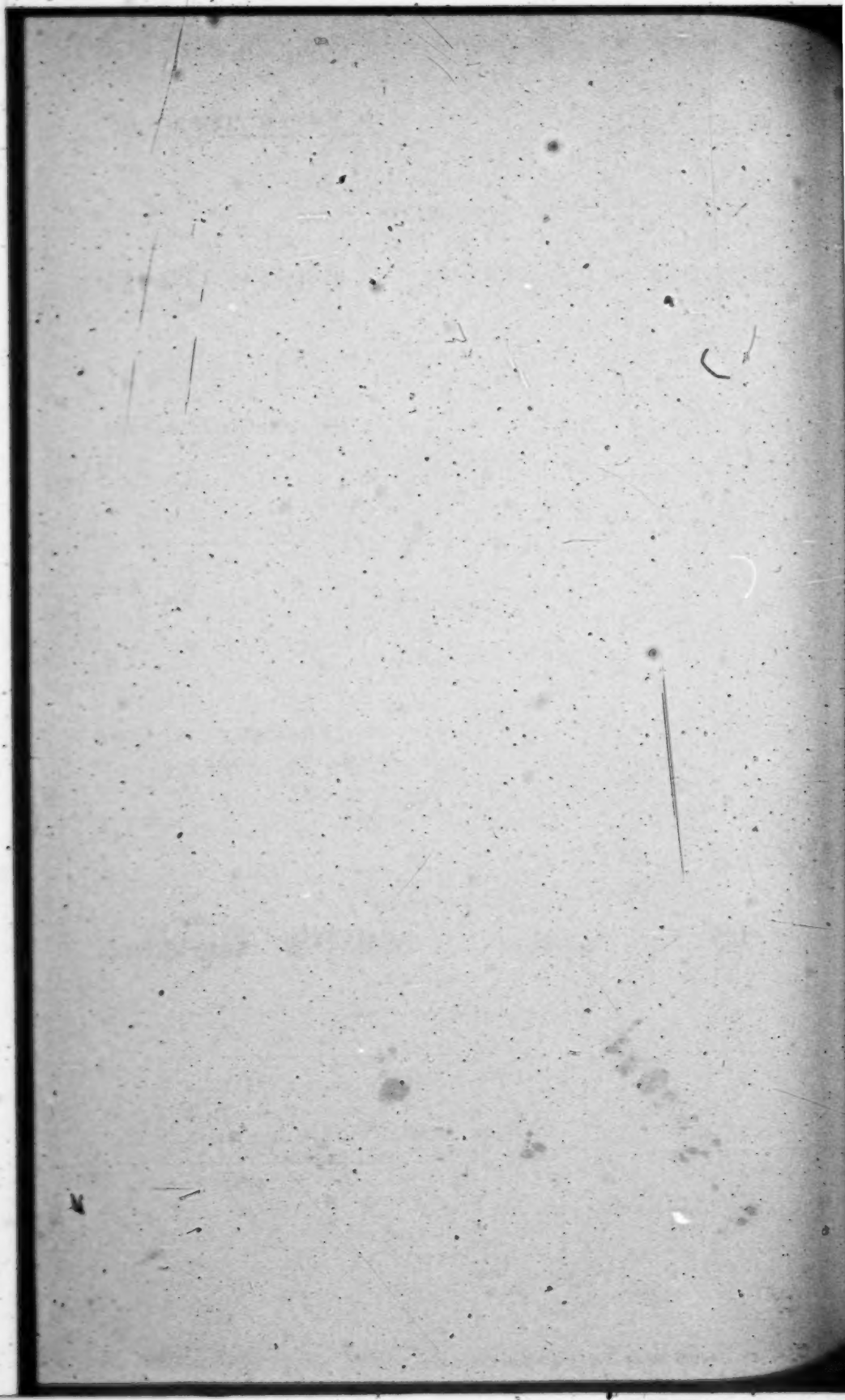
The opinion of the learned Circuit Court of Appeals clearly shows in the statement of facts how singular is the case of this respondent, and his associates as to whom the petitions have been filed, and how obvious the conclusion must be that the decision of these cases cannot be a precedent generally. This fact would seem sufficient to justify the denial of the petition for a writ of *certiorari*. U. S. *v.* Rimer, 220 U. S. 547; Furness, Withy & Co. *v.* Yang-Tsze Ins. Ass'n, 242 U. S. 430. The most casual reading, however, of the opinion of Judge Woolley, for the Circuit Court of Appeals, shows how well founded, in passing upon these unusual facts, are his conclusions of law, and that they so fully accord, in principle, with all

of the applicable decisions of this Court that there is no reason for a further hearing because the ultimate result would appear to be an affirmance of the judgment rendered below.

It is respectfully submitted that the petition for the writ of *certiorari* in the above entitled cause should be denied.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 199.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

SAMUEL F. HOUSTON.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

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OCTOBER TERM, 1930. No. 199.

David Burnet, Commissioner of Internal Revenue, Petitioner,

v.

Samuel F. Houston.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals (R. 56) is reported in 39 F. (2d) 351. The findings of fact and the opinion of the Board of Tax Appeals (R. 9-16) are reported in 13 B. T. A. 279.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered March 14, 1930 (R. 63). Petition for certiorari was filed in this Court on June 14, 1930, and was granted October 13, 1930 (R. 64). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF QUESTION INVOLVED.

Where a taxpayer in 1906 enters into a transaction for profit wherein, as part of the plan of reorganization of a Trust Company in the hands of a Receiver, he subscribed money to guarantee a specified value to certain specific assets held by it, under a written agreement that he is to be repaid only out of the excess realization over said specified amount from the uncontrolled administration of said assets by the Trust Company, and said administration is concluded after fourteen years and the taxpayer receives a first and final dividend on the amount of money advanced by him, is not the difference between the amount advanced by the taxpayer and the amount received from the final administration a deductible loss to the taxpayer under Section 214 (a) 5 of the Revenue Act of 1918, for the year in which the first and final distribution is paid?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are printed in Appendix to Petitioner's brief pp. 18-20.

STATEMENT OF THE CASE.

The statement of facts in the petitioner's brief, while substantially correct in so far as it goes, omits certain facts

which are essential to give a clear picture of the transaction out of which the respondent's loss arose, and respondent feels obliged therefore to restate the facts in more detail. The omission by the petitioner of all reference to the nature of the transaction which was found by the Board of Tax Appeals and the Circuit Court of Appeals to have been that in the nature of *a guaranty*, essentially changes the aspect of the case.

The facts as found by the Board of Tax Appeals (R. 10-14) and as appear elsewhere in the record where specifically noted, are as follows:—

The respondent was a stockholder and director of the Real Estate Trust Company of Philadelphia.

The Real Estate Trust Company of Philadelphia closed its doors in the year 1906, and on August 28th of that year, George H. Earle, Jr., was appointed receiver for it by the Court of Common Pleas of Philadelphia County, Pennsylvania. The financial embarrassment of the Real Estate Trust Company was brought about by improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to Adolph Segal and took therefor collateral which could not be easily liquidated, but which was not without value.

The receiver for the Real Estate Trust Company proposed a plan of reorganization for that company which included as one of its provisions the creation of a fund of $2,505,000 from subscriptions by directors of the company to guarantee a value of $3,000,000 for the Segal collateral, designated in the plan "Segal Matters." The company was to be given the $2,505,000 outright and then was to have in addition the first $3,000,000 which might be realized from the "Segal Matters." The subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal Matters." This plan of reorganization became effective. It provided in part that the subscribers to the $2,505,000 fund made such subscriptions with the understanding that if from the administration of the "Segal Matters" $3,000,000 should be realized, the

subscribers were to receive any excess over this amount. No restrictions or time limits were placed upon the Real Estate Trust Company in regard to its administration and final disposition of the assets included in the "Segal Matters." The Real Estate Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal Matters" were administered exclusively by it under the direction of George H. Earle, Jr., formerly receiver and thereafter president of that company.

The respondent, a director, subscribed $755,000 to the fund and when the plan became effective by the required consents of creditors, stockholders, and others, and the subscribers to this fund were called upon to make payment of their subscription, respondent found that a payment by him of the full amount of his subscription would necessitate a sacrifice of his securities and investments in the then existing market at considerable loss to him, and at his proposal his sisters, and his mother took participating interests in his subscription. Of the $755,000 subscribed by respondent, respondent actually contributed $305,000 of his own money and his sister, Sallie H. Henry, contributed $200,000 to the fund.

The respondent at the time he subscribed to the guaranty fund believed that the "Segal Matters" had considerable potential value which under Earle's administration could be converted into a sufficient amount of cash to repay the subscribers the amount of their subscription with interest and possibly some profit in addition.

At and before the time that the respondent herein subscribed to the guaranty fund, George H. Earle, Jr., the receiver for the Real Estate Trust Company, had had conversations with the directors in which he expressed a belief that a sufficient amount might be realized from the "Segal Matters" to repay to the subscribers the amount of their subscription with interest and possibly a profit.

The facts as further found by the Board show that Segal had secured a loan of $1,250,000 from Gustave E. Kissel. As collateral for this loan, Segal gave certain

bonds and stock which had been deposited with the Real Estate Trust Company as collateral security for loans made by it to Segal and which had been wrongfully withdrawn from the Real Estate Trust Company by Segal with the permission of Hipple. Included in this collateral were certain bonds and shares of stock of the Pennsylvania Sugar Refining Company and in connection with the loan it was agreed between Kissel and Segal that until the loan was repaid, Kissel, or some one to be named by him, should have the right to select four out of seven directors of the Pennsylvania Sugar Refining Company and that the latter's refinery should not be operated.

At the time the subscriptions to the guaranty fund were made, a suit against the American Sugar Refining Company under the Sherman Anti-Trust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company and the value of the "Segal Matters" depended to some extent upon the successful prosecution of such a suit.

Such a suit was brought in the United States District Court for the Southern District of New York for $10,000,000 and another in the Court of Chancery in the New Jersey, on the ground that Kissel, as agent for American Sugar Refining Company, had made a contract in restraint of trade with Segal. In January, 1910, the pending litigation was compromised upon the delivery to the Real Estate Trust Company by the American Sugar Refining Company of certain bonds wrongfully withdrawn from the Real Estate Trust Company among which were bonds of the Pennsylvania Sugar Refining Company. The Real Estate Trust Company afterwards converted the latter bonds, through a foreclosure, into 7268 shares of stock in the reorganized company, thereafter called Pennsylvania Sugar Company. This was on or before January 22, 1912.

Some question arose between the parties in regard to the interpretation of the subscription agreement and on May 5, 1916, a supplemental agreement was entered into. At this time and for some time prior thereto the principal unliqui-

dated assets of the original "Segal Matters" were the 7268 shares of stock in the Pennsylvania Sugar Company and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds, but in no event more than their original subscriptions.

In the latter part of 1920, the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Whereupon, the subscribers either individually or by their duly constituted representatives entered into separate agreements which as a group provided for complete liquidation of the "Segal Matters" by the Real Estate Trust Company distributing one-fourth of the 7268 shares of Pennsylvania Sugar Company stock to the subscribers to the fund in proportion to the amount of their subscription in full satisfaction of all agreements of the parties pertaining thereto. The subscribers never received any other return on their subscriptions.

Samuel F. Houston entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of Pennsylvania Sugar Company stock. He, personally, was entitled to 222 of these shares. The remaining shares he received for his sisters and others who had subscribed through him. These latter shares were later distributed to them by him, 158.61 shares being delivered to Sallie H. Henry in the early part of 1921.

Each share of Pennsylvania Sugar Company stock received by the respondent at the time received had a fair market value of $150.

At the end of 1920, Samuel F. Houston wrote off his books as a loss of $271,700 computed by deducting the value of the stock which he received from $305,000, the amount of his subscription. In reporting income for 1920 he deducted this amount as a loss.

As further appears (R. 44-45) this loss was allowed by the Field Agent but disallowed by the Commissioner in a letter of June 2, 1924, for the reason therein given:—

> "In regard to the disallowance of $271,700.00 you are advised that under the provisions of Revenue Act of 1918, no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of, and the evidence is to the effect that the stock was still in your possession at the close of the year 1920."

This rejection was affirmed by the Commissioner December 18, 1925 (R. 6), and on an appeal to the Board of Tax Appeals by respondent, the action of the Commissioner was sustained for the reason that respondent failed to show what the March 1, 1913, value was of his interest in the guaranty agreement.

SUMMARY OF ARGUMENT.

The respondent proved a loss deductible in 1920 under Section 214 (a) 5 of the Revenue Act of 1918, upon a guaranty transaction entered into in 1906. This loss is a permissible deduction *in toto*, no valuation as of March 1, 1913, of respondent's right or position with respect to the Trust Company's administration being relevant. If March 1, 1913, value of respondent's position as guarantor is relevant, respondent, under the record facts, has sustained such burden of proof as may rest upon him by showing that his entire loss occurred after March 1, 1913. The Commissioner offered no proof to the contrary.

ARGUMENT.

It is submitted that from the peculiar facts of this case, the only proper basis for measuring petitioner's admitted loss is by taking the basis adopted by petitioner in making

his return, namely—the difference between his subscription to the Guaranty Fund in 1906 and the value of the pro rata share of the proceeds of said fund received by him in 1920. The nature of the entire transaction admits of no other basis.

The Real Estate Trust Company of Philadelphia was reorganized and reopened for business November 1, 1906. George H. Earle was discharged as receiver and elected President of the Trust Company. The "Segal Matters" were administered by George H. Earle in his capacity as President of the Trust Company in which was vested, by the terms of the Guaranty Fund agreement, the exclusive and uncontrolled power of administration and liquidation of the "Segal Matters."

In the course of the administration, which extended far beyond the time originally contemplated, differences of opinion developed upon the position and powers of The Real Estate Trust Company, upon the one side, and the contributors or their estates, upon the other.

It was decided by the parties in interest in 1915, while the "Segal Matters" were still being administered by The Real Estate Trust Company for its own account and as trustee for the subscribers, that an interpretation of the original agreements should be obtained from John G. Johnson, Esq., of Philadelphia, who was counsel for George H. Earle, Receiver, and joint author with him of the plan of reorganization of The Real Estate Trust Company. The opinion of Mr. Johnson was asked for and was rendered under date of July 15, 1915 (R. 33).

Mr. Johnson held that the "Segal Matters" were subject to sole administration by The Real Estate Trust Company within its uncontrolled discretion, and that the subscribers to the Guaranty Fund were entitled only to the exercise of an honest administration of ordinary prudence and intelligence and without power to interfere with or direct the manner or time of liquidation.

He further held that when the amount of realization reached Three million dollars, from whatever source ac-

quired, the right of the Trust Company to any additional payment ceased and the right of the subscribers attached, and thereafter all proceeds from the disposition of Segal assets became the property of the subscribers to the fund.

It is to be remembered that Mr. Johnson's opinion was given while the administration of the "Segal Matters" was continuing and speaks of the future when interpreting the rights of the parties to interest, as well as to a pro rata share in the proceeds realized from liquidation of principal assets.

The conclusion which he reached formed the basis for the subsequent agreement entered into between the parties. Mr. Johnson said (R. 33, 36):—

> "Interest is to be allowed in case of an excess sufficient in amount; but it is to be allowed only to the contributors upon the amount of their contributions.
>
> "In my judgment, therefore, the contributors are entitled to any excess in the realization of the 'Segal Matters' which will arise after there has been received from the 'Segal Items' by way of proceeds of sale, and income anterior to their conversion, the sum of $3,000,000."

Mr. Johnson also stated that in his opinion the power to administer by the Trust Company exclusively was not limited by any duty to consult with the subscribers or their representatives (R. 36).

The administration of the "Segal Matters," which in 1916 included stock of the Pennsylvania Sugar Company, continued under the sole direction of The Real Estate Trust Company of Philadelphia until the latter part of the year 1920. It was then agreed between The Real Estate Trust Company and the subscribers to the Guaranty Fund that the agreement with the Trust Company for the administration and liquidation of the "Segal Matters" had served its maximum of usefulness and that thereafter no additional advantages could come from it to any of the parties to it, and that pursuant to the supplemental agreement of May 5, 1916,

it was desirable to terminate the relationship theretofore existing and to liquidate the "Segal Matters" by a distribution in kind to the subscribers of the pro rata share to which each was entitled of the stock of the Pennsylvania Sugar Company.

The agreement of December 30, 1920 (R. 40), was thereupon entered into between The Real Estate Trust Company and each of the subscribers, approved by the members of the Committee, by which distribution in kind was made.

It must be conceded that the basis for the transaction, and the reason why it was entered into, was the expectation of the subscribers that the administration and liquidation of these "securities of uncertain value" would produce a profit to them. This, in effect, was what the Contract of Guaranty was. The subscribers backed their confidence in the hopes of success by their subscriptions, expecting in time that the "Guaranty Fund" would repay with profit. This justifiable expectation continued up to and beyond March 1, 1913. There are no facts upon the record or available for the record to show that as of March 1, 1913, there was not ample foundation for the realization of this expectation.

The respondent contends that for the purpose of determining the tax liability the status of the respondent is no different than it would have been had the subscribers to the Guaranty Fund signed an agreement of guaranty, instead of creating the fund, by which agreement each would have obligated himself to pay his pro rata share of the difference, if any, between $3,000,000 and the amount realized from the "Segal Matters," in consideration of an agreement on the part of the Trust Company that in the event that the "Segal Matters" realized more than $3,000,000 the entire excess should be distributed pro rata among the guarantors.

If such had been the agreement then, in 1920, the respondent would have been called upon to make good his contract of guaranty by the payment of the sum of $271,700. This payment in discharge of that liability would have created a loss in the year when paid. The transaction would

not have produced the anticipated profit, but the loss would have been deductible from the gross income of the respondent in the year when the payment was made.

The total realizable value of the "Segal Matters" which was underwritten by the guarantors in 1906 fell short of the speculative possibilities anticipated for them. The transaction when closed in 1920 was not a profit but a loss. The loss fell upon the guarantors and the extent of it was reflected in the amount of the balance returned to them from the assets which replaced their cash deposited with the "Guaranty Fund" to protect their guaranty.

The ordinary policy of indemnity; the policies covering marine risk, including profit on the cargo for the voyage; marketability of real estate titles and of mortgage bonds; and many other well known, every-day, undertakings are similar in principle to the transaction under consideration. In all such, the loss incurred by the guarantor or indemnitor when it becomes actual has never been disputed as a deductible loss from gross income.

Neither the respondent, nor the Court below question the fact that the cases such as United States *v.* Flannery, 268 U. S. 98; Heiner *v.* Tindle, 276 U. S. 582, and others mentioned in the brief for petitioner, measure the loss on the ordinary transaction entered into before March 1, 1913, relating to property owned outright by the taxpayer by adopting either the value as of that date or the cost, whichever is lower, as the base. But all the authorities which have come to counsel's attention in this transaction have dealt with the property inherently capable of ascertainable value, such as real estate, an insurance policy, instruments evidencing debt and the like. In none of them has the Court applied a March 1, 1913 value to a loss or right of the character herein involved, where the loss of a guarantor, or the value of his correlative right to reimbursement, is not properly ascertainable until the guaranty transaction is liquidated.

It is submitted that the respondent in this case is not asking on this point more than an application of a principle which

if true in denying the right to anticipate a loss, is true also in determining when a loss first occurs, and that neither the date of the transaction which ultimately resulted in the loss, nor any date intermediate between that date and the date of the closing of the transaction, is material. In other words, if the loss on this transaction is of such nature that it can only be determined on one date, namely, December 30, 1920, how can March 1, 1913, have any bearing on such a transaction? This is not a case where a loss can be measured as of March 1, 1913, and December 30, 1920, such as might be the case with the purchase and sale of property. In the latter case there could be a measurable loss or gain in 1913 and in 1920 or at any intermediate date. In this case, the loss can only be determined with reference to one date, *i. e.*, the date when the transaction was liquidated. The provision in the Statute with reference to 1913 values, we submit, is only applicable to property, the loss or gain on which can be ascertained as of that date.

This reasoning seems to find support in the case of Lewellyn, Collector of Internal Revenue *v.* Electric Reduction Company, 275 U. S. 243, in the opinion in which Mr. Justice Stone says:—

> "The statute was intended to apply not only to losses resulting from the physical destruction of articles of value but to those occurring in the operations of trade and business, where the business man has ventured on a course of action in the reasonable expectation that the promised conduct of another will come to pass. Not only the future success of the business but its present solvency depends on the probable accuracy of his prophecy. Only when events prove the prophecy to have been false can it be said that he has suffered. His case is not like that of a man who fails to learn of the theft of his bonds or the burning of his house until a year after the occurrence; but rather resembles the position of a merchant who buys in one year, for sale in the

next, merchandise which shifting fashion renders unsaleable in the latter. It may well be that he whose house has been burned has sustained a loss wehther he knows it or not and may recover a tax paid in ignorance of that material fact. But we cannot say that the merchant whose action has been based not merely on ignorance of a fact but on faith in a prophecy—even though the prophecy is made without full knowledge of the facts—can claim to have sustained a loss before the future fails to justify his hopes.

"Here the only fact relied upon to show a loss is the outcome of the litigations two years after respondent's payment to Jouravleff. There is nothing in the findings from which we could conclude that the respondent in 1918 had ceased to regard his rights under the contract as having value or that there was then reasonable ground to suppose that efforts to enforce them would be fruitless."

It follows from this language that had the respondent claimed a loss in 1913, the petitioner would have disallowed it because of no evidence to support it and the affirmative proof that respondent had not ceased to regard his rights under the Guaranty Agreement as having full valie (R. 49) and this Court apparently would have sustained that finding on the authority just cited. If no deductible loss was available to the petitioner in 1913, it is because the facts failed to show a difference in his position from what it was in 1906—and it cannot be said, therefore, that the actual loss determined in 1920 and not previously ascertainable, must be diminished by assuming that had the transaction closed on March 1, 1913, the loss would have been the same, or greater or less. The statute does not so provide and the reasoning of this Court seems to sustain the Court below in its decision to the contrary.

It is respectfully submitted that these cases, growing out of the Real Estate Trust Company failure, are so dis-

similar from other cases arising under the revenue acts as to create a class for themselves, and to be unavailable as authority for future litigation.

The argument for the petitioner is based on that misconception of the transaction from which the respondent's loss resulted which caused counsel for the petitioner to ignore certain of the facts of record which are essential to a clear understanding of the differences presented by these cases from the authorities relied upon by the petitioner and other decisions of this and the lower Federal courts.

The petitioner apparently understands the transaction under consideration to have been a purchase in 1906 of tangible property by the respondent and a disposition of such tangible property interest in 1920 at less than cost, and because of such understanding has presented the question involved to this Court as one of the ordinary and usual claims for loss arising out of the "sale or other disposition of property, real, personal, or mixed." (Section 202 (*a*) (1) of the Revenue Act of 1918, Appendix to Petitioner's Brief, p. 18.)

The transaction was not that which the petitioner's description presents, and the findings of fact of the Board of Tax Appeals, affirmed by the learned Court below and the basis for its opinion, clearly disclose the relationship of the respondent to the transaction in 1906 to be different from that of the purchaser of tangible property interests.

The transaction, as found by the Board of Tax Appeals, was one entered into by the respondent as a part of the plan of the reorganization of the Real Estate Trust Company of Philadelphia by which the respondent became a subscriber to "the so-called guaranty fund, and in accordance with the agreement of reorganization paid to the Real Estate Trust Company the amount of the respondent's subscription in the year 1906" (R. 15):—

> "This money was thenceforth the property of the Real Estate Trust Company and the subscribers to the fund were to look solely to the excess proceeds which

the Real Estate Trust Company might subsequently realize on certain assets which were called 'Segal matters.' If and when the amount realized by the Real Estate Trust Company from the administration of these 'Segal matters' amounted to $3,000,000, any additional amount which might thereafter be realized from the further administration or disposition of these assets was to belong to the subscribers to the fund."

The Real Estate Trust Company had the power of administration in its sole discretion and was required only to use due diligence and reasonable judgment in the administration, disposition and final liquidation of the "Segal matters." The administration of these assets began in 1906 and were not completed until 1920. The subscribers to the guaranty fund acquired no securities or "rights" of a tangible nature, and at no time had an ownership of or an interest in the "Segal matters," but acquired by the transaction of 1906 as a result of the subscriptions then made to the guaranty fund a position in relation to the Real Estate Trust Company which entitled the respondent and the other subscribers to an accounting when the administration was terminated and a pro rata participation in the proceeds realized in excess of the sum agreed upon as the amount required to replace the capital and surplus of the Trust Company. This right to an accounting and the proceeds thereof the learned Court below described as follows (R. 62):—

"To work out this aspect of the question it will be necessary to determine generally the interest of the contributors, and particularly the petitioner's interest in the Segal matters. It is, because of their nature, difficult to give them a legal definition. Speaking of them in the singular number, it is certain that the petitioning contributor had no legal interest in the Segal securities or matters, or any legal claim to them. Legal title and the right fully to dispose of them was exclusively

in the trust company. The petitioner had, however, a right to a share of the residue of the proceeds of their liquidation, whether in cash or its equivalent. That right was in the nature of a chose in action, yet a very restricted chose in action which he could not enforce until liquidation of the Segal matters had been fully completed, whenever that should be."

The purpose of the guaranty fund was to insure to the Trust Company, in 1906, liquid assets for use in its business as a going concern pending the realization upon the "Segal matters" then estimated to be of great value although of "uncertain value." The original proposed guaranty in lieu of cash was in the form of notes of the subscribers (R. 50). Payment of these notes, as subsequent history shows, would have been made pro rata in 1920. The substitution of a guaranty fund in cash in lieu of the notes was made necessary so that the Trust Company when re-opened in 1906 should have a more liquid position than such notes of the guarantors would have afforded.

The relationship, however, of the subscribers to the Trust Company in the transaction was still that of guarantors with the expectation that the guaranty fund, plus a profit, would be returned to them. This relationship seems to the respondent essentially different from that of the taxpayers in the cases relied upon by the petitioner, and it is asserted for the respondent that Section 202 (a) (1) of the Revenue Act of 1918, and the regulations promulgated thereunder, by language and intent, have no application to the transaction out of which arose the loss claimed by the respondent under Section 214 (a) (5) of that Statute.

The argument for the petitioner, if applied to the actual facts of the transaction under consideration and not to the relationship as inaccurately described in the petitioner's brief, would require that in every contract of suretyship or guaranty entered into prior to March 1, 1913, and resulting

in a loss thereafter, the position of the surety or guarantor must be valued as of March 1, 1913, in determining the amount of the deductible loss allowable in the year when the transaction involving the suretyship or guaranty is closed. The language of Section 202 (a) (1) of the Act of 1918 certainly does not *expressly* justify such a contention, and there is no *reasonable implication* from that language of the statute that to determine the loss allowable under Section 214 (a) (5) such a valuation of the guarantor's position is required.

Evidence which is reasonably conclusive that the administrative department of the Government placed no such construction upon Section 202 (a) (1) is found in the reason of the Commissioner of Internal Revenue for disallowing the loss claimed by the respondent. This reason includes no suggestion that the respondent failed to establish his loss upon the basis of the provisions of Section 202 (a) (1), nor was the claim of loss disallowed by the Commissioner by reason of a finding by him that the respondent's position had no value on March 1, 1913, but was for the reason that (Record, p. 45) :—

> "In regard to the disallowance of $271,700.00, you are advised that under the provisions of revenue act of 1918 no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of, and the evidence is to the effect that the stock was still in your possession at the close of the year 1920."

The petitioner in the brief below, and in the brief filed on this hearing, does not refer to any provision of the revenue acts, the regulations promulgated thereunder, nor to any reported case, embodying the requirement imposed by the argument for the petitioner here that a loss arising out of a transaction in the nature of a guaranty requires a valuation of the guarantor's position as of March 1, 1913, before the

loss actually sustained and deductible under Section 214 (a) (5) may be allowed.

An analagous situation would be an agreement of guaranty entered into in 1906 by A as guarantor of the indebtedness incurred by partnership B and partnership C in neither of which was A a member, with a manufacturer from whom they purchased goods; the consideration to A being that each of the dealers would pay to A a percentage of the profits realized on the sale of the goods purchased from the manufacturer holding the agreement of indemnity at the expiration of the time when each partnership ceased selling these goods. The relationship between the selling partnerships and the manufacturer continued until 1920. In that year partnership B ceased to purchase from the manufacturer, dissolved and having paid in full all of its indebtedness to the manufacturer, showed a substantial profit on the goods which it had sold, from which A was paid the agreed percentage. Partnership C showed a substantial loss when liquidated, resulting in the payment by A on his agreement of indemnity of a substantial sum to the manufacturer from whom C had purchased the goods which it had sold.

Is it conceivable that, in determining the income tax liability of taxpayer A for the year 1920, the income in the form of the profits received from partnership B and the loss sustained by the payment under his contract of guaranty of the indebtedness due by partnership C to the manufacturer are not determinable without a valuation of A's position under his two contracts of guaranty as of March 1, 1913? It would seem that an attempt by A so to do would be met by serious opposition on the part of the Commissioner of Internal Revenue.

Another example would be afforded by the situation where A in 1912 agrees to sell merchandise to B with deliveries running into 1914 and guarantees B against any fall in the 1914 market price as compared to the contract price. Even though the market had fallen in 1913, *non constat* but that it would rise in 1914 and hence A's possible loss in 1913

theoretically based on a 1913 market, would appear to be irrelevant. See in this connection:

Highland Milk Condensing Co. *v.* Phillips, 34 Fed. (2d) 777, certiorari denied 280 U. S. 608;
Ewing Thomas Converting Co. *v.* McCaughn, 43 Fed. (2d) 503.

A further analagous situation, because it involves similiar contingencies, may be found in the reported cases passing upon the tax liability of an insurance agent as to renewal premiums paid under contracts of agency entered into prior to March 1, 1913.

Workman *v.* Commissioner of Internal Revenue, 41 Fed. (2d) 139 (C. C. A. 7th Circuit). In this case, the taxpayer received in the years 1920 to 1924 various amounts on renewal premiums of policies, which as agent for an insurance company, he had written prior to March 1, 1913. His contract with the insurance company entered into in 1908 entitled him to receive commissions on renewal premiums, regardless of the termination of his agency. In making his returns of income for 1922, 1923 and 1924, he excluded the amount of the commissions received in those years on the renewal premiums, presumably on the theory that the March 1, 1913, value of the anticipated payments to him under his contract exceeded the amounts actually received by him in said years. The Commissioner determined that the taxpayer's income should be increased by the amounts actually received in the years in question. The Court sustained the action of the Commissioner and in considering the nature of the taxpayer's right says (p. 141) (quoting from another case):—

"* * * Although the right had value, it lacked an essential element; no renewal premium might ever be paid, and in that event he would receive nothing more; or renewals might be paid only in part, and then he would be entitled to commission on that part only. The insured might die before a given renewal fell due,

or he might allow his policy to lapse, and in either event the right of the agent to future commissions perished. The right, therefore, was contingent; his contracts so provided, for they declared that commission should accrue only as premiums should be paid in cash, and certainly until such payment should be made he had no collectible claim against the society. He had a property right that had value, but contained also an element of risk, and unless he turned it into money it remained contingent. The act taxes money, or its equivalent, or its representative, and a contingent right such as this is not 'income' in the sense used by the act. * * *

"Of course, there are instances where such contingent rights to commissions have been bartered and sold, and present values have been placed upon them by reference to mortuary tables and lapsing probabilities, with reliable accuracy; but the contingency is never eliminated so far as the agent is concerned, nor is the contingent right ever impressed with the characteristics of capital so long as the agent's right to receive it is contingent upon the nonlapsing of the policy."

The petitioner asserts that until the respondent has established the value of his position on March 1, 1913, there is no basis for determining his deductible loss, and that not only did the respondent fail to discharge this burden, but the evidence shows that "respondent's property right *had no value* on March 1, 1913." (Petitioner's Brief, p. 14.)

The basis for this assertion, as shown by the Petitioner's Brief, is that the principal unliquidated asset of the original "Segal Matters" on March 1, 1913, was 7268 shares of stock of the Pennsylvania Sugar Company, and the petitioner asserts that there was an ascertainable market value for this stock which, if ascertained, would show that the respondent's participating interest in such stock was of no value whatever.

This argument needs many assumed facts to support it

not to be found in the record and again misstates respondent's relationship to the Segal Matters in important particulars.

The respondent had no property right in the Segal Matters as such, and market values as of March 1, 1913, were of no greater use to the respondent then than they are relevant to this case now, because, regardless of market values for whatever the Segal Matters might then have been, the respondent had no power to direct the administration by the Real Estate Trust Company and no means of requiring a liquidation in 1913 of the assets which were in its hands for its sole control.

The record shows that there was no termination of the administration by the Trust Company prior to March 1, 1913, and until that event occurred the respondent was without power to require an accounting by which to ascertain the value of his position.

The Trust Company in its uncontrolled discretion continued its administration beyond March 1, 1913, and without change in the original agreement, at least until May 5, 1916. During the entire period of such administration and at the time the supplemental agreement of the later date was entered into all parties evidenced the expectation of a realization of their original subscriptions to the guaranty fund with profit or interest.

The record shows opinion evidence, competent to prove as a fact that the respondent's position as a guarantor had, on March 1, 1913, at least the value of his original contribution to the guaranty fund. This is found in the oral testimony of Samuel F. Houston (R. 49)—

> "At the time the agreement of 1916 was entered into by me I was of the opinion that if the sugar company was as successful as we anticipated and hoped the much-desired result that the Real Estate Trust Company would work out from the Segal assets a sum sufficient to return to the subscribers the amount of their contributions need not be a matter of very long time."

and in the provisions in writing of the supplemental agreement of May 5, 1916, executed by the respondent and the other parties in interest (Exhibit No. 4, R. 37-39).

Paragraph Fourth of this supplement agreement (R. 38) reads as follows:—

> "*Fourth.* That as a further consideration and adjustment that would make possible the participation of the contributors to the $2,505,000 fund so as to secure at least some return upon their equity, it is hereby provided and agreed that should the Real Estate Trust Company of Philadelphia, in its discretion, dispose of any or all of the stock of the Pennsylvania Sugar Company, owned by the trust company as part of the 'Segal Matters' twenty-five per cent. of the proceeds of such sale or sales, or so much thereof as may be required to return the contributions without interest, shall thereupon be distributed pro rata among the contributors to the said $2,505,000 fund on account of their contributions up to the amount of the same which at that time shall remain unreturned. The remainder of the proceeds of any such sale or sales shall be and remain the absolute property of the Real Estate Trust Company of Philadelphia."

The language of this agreement, involving matters so important to all concerned, cannot be lightly brushed aside, but must be given proper weight as a clear indication that even as late as 1916, the respondent and other subscribers to the guaranty fund had a reasonable expectation of a return of their subscriptions made in 1906.

On the other hand, the Trust Company, administrator, and the members of its board, in conceding by this agreement an opportunity to the subscribers to the guaranty fund to realize from sales from time to time, if and when made, of the share of stock of the Pennsylvania Sugar Company, a participation, to the extent of twenty-five per cent. of the

proceeds of such sales, instead of requiring them to await the final recoupment to its full extent of the original position of the Trust Company, obtained, as a consideration for this earlier payment, a waiver by the subscribers of the excess profits then anticipated from the sale of *all* of such stock and the acceptance of the original contribution only and no additional profit.

The "Segal Matters" had in 1906 an *uncertain value*. This fact is stipulated in the record (p. 21). As of March 1, 1913, they had an equally *uncertain value*. In either case all parties familiar with the possibilities of the administration by the Trust Company confidently anticipated an ultimate realization to the subscribers to the guaranty fund of their original subscriptions with interest or profit. The most that could be required of this respondent was that, in the language of Relnecke *v.* Spalding, 280 U. S. 227, he should prove that the value of his position on March 1, 1913, was at least not below what it was as a member of the Guarantors' group in 1906. This he has done.

The action of this respondent throughout was based, as Mr. Justice Stone said in Llewellyn *v.* Electric Reduction Co., 275 U. S. 243, "on faith in a prophecy," and at no time while his faith continued was he in a position "to claim to have sustained a loss, before the future" failed "to justify his hopes."

CONCLUSION.

The decision of the Circuit Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

WM. CLARKE MASON,
JOHN RUSSELL, JR.,
Attorneys for Respondent.

MORGAN, LEWIS & BOCKIUS,
Of Counsel.

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IN THE

Supreme Court of the United States

October Term, 1930.

No. 199.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,
vs.
SAMUEL F. HOUSTON,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

MOTION FOR LEAVE TO APPEAR AND FILE A BRIEF AS AMICUS CURIAE, AND BRIEF.

JAMES CRAIG PEACOCK,
Counsel for Mrs. J. I. R. Henry, Executrix of the will of Bayard Henry, Deceased.

GERALD RONON,
Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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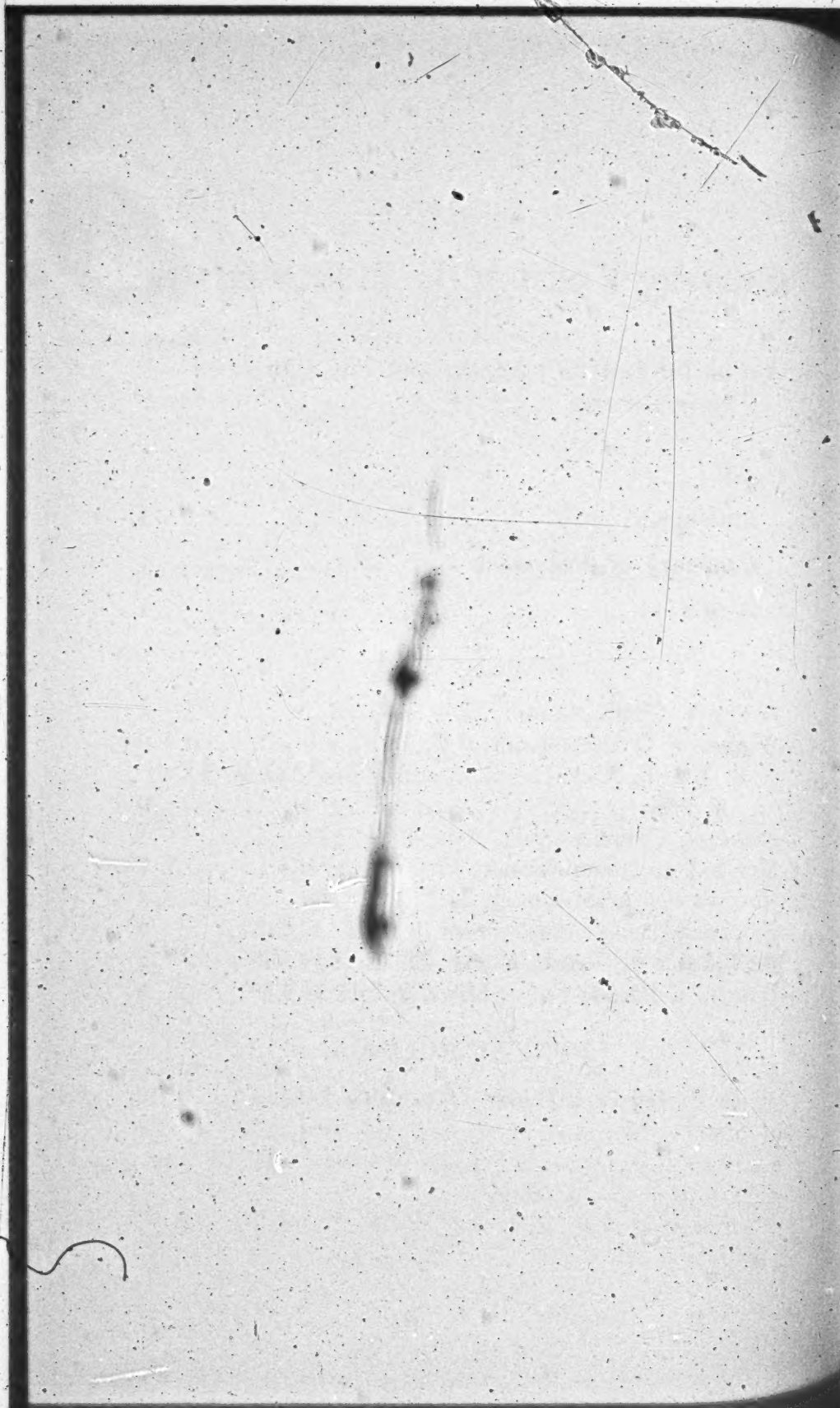
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IN THE

Supreme Court of the United States

October Term, 1930.

No. 199.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,
vs.
SAMUEL F. HOUSTON,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

MOTION FOR LEAVE TO APPEAR AND FILE A BRIEF AS AMICUS CURIAE.

Now comes James Craig Peacock of Washington, D. C., counsel for Mrs. J. I. R. Henry, executrix of the will of Bayard Henry, deceased, and presents this his motion for leave to appear and file a brief in the above-entitled cause as *amicus curiae*, and in support of this motion shows:

An appeal filed with the United States Board of

Tax Appeals by the late Bayard Henry (who died September 17, 1926, and whose executrix, J. I. R. Henry, was thereupon substituted as petitioner) arose out of the same facts and involved identically the same issue as the three cases which are now before this court as Nos. 199, 202, and 203. All four cases were consolidated for trial before the Board and were tried and decided together (R. 9, 10). The complete facts and figures in the case of Bayard Henry will be found included in the record in the present case (R. 9-14, 22-23, 33, 41). The appeal of Bayard Henry having been filed with the Board prior to the passage of the Revenue Act of 1926, his executrix elected to pay the additional tax with the right to file a claim for refund and a suit in the District Court instead of filing a petition for review in the Circuit Court of Appeals as was done by the other three taxpayers whose cases are now here on the Government's petitions for certiorari. Mrs. J. I. R. Henry, as executrix of Bayard Henry, has, however, just as direct an interest in and will be just as directly affected by the decision of this court as any of the parties in Nos. 199, 202, and 203.

WHEREFORE, it is prayed that an order be entered permitting James Craig Peacock to appear as *amicus curia* in the above-entitled case, with leave to file the brief attached hereto.

Respectfully submitted,

JAMES CRAIG PEACOCK,
Counsel for Mrs. J. I. R. Henry, Executrix of the will of Bayard Henry, Deceased.

GERALD RONON,
Of Counsel.

BRIEF.

STATEMENT

The facts are correctly enough presented in the Government's brief *with the exception of one serious omission.* The reorganization plan did not include merely "the creation of a fund of $2,500,000 from subscriptions by directors of the company" as it is described in lines 8 and 9 on page 3 of the Government's brief. It was expressly found by the Board of Tax Appeals that "the creation of a fund of $2,500,000 from subscriptions by directors of the company" was "to *guarantee* a value of $3,000,000 for the Segal collateral, designated in the plan 'Segal matters'" (R. 11). The Board also found on each page of its findings that the fund was "the *guaranty* fund" (R. 11, 12, 13, 14).

We unqualifiedly concur in the decision of the Circuit Court of Appeals that the amount of each subscriber's loss had been properly determined in his original return as the difference between his subscription to "the guaranty fund" in 1906 and the value of his prorata share of the proceeds of that fund when received by him in 1920 or 1921 (R. 63). We likewise fully concur in the reasoning whereby that court below reached that conclusion.

We feel, however, that for a still further and entirely independent reason, which arises out of this transaction being one *of guaranty* and which was not considered by the court below, the same conclusion must also and inevitably be reached. That is the only occasion for the present brief, which will be strictly confined to consideration of that one further reason

why the judgments in No. 199 and the two related cases should be affirmed.

Summary of Argument

That further reason is that the transaction was essentially *one of guaranty* and for income tax purposes its status as such can not be ignored. It has already become established, and correctly so, that for such purposes a guarantor's loss is wholly sustained at the time when the transaction is closed and in the amount by which he is actually out of pocket. These principles require that the decision of the court below should be sustained.

Argument

First as to the facts. This case is before this court on the findings of fact made by the Board of Tax Appeals and printed at R. 10-14. The Board expressly found that the purpose of the fund in question was "to guarantee a value of $3,000,000 for the Segal collateral" (R. 11), and equally as expressly and at least six times in the course of its comparatively short findings found the fund to be "the guaranty fund" (R. 11, 12, 13, 14). These findings are conclusive and are not subject to court review where as here the only issued raised is one of law. *Avery v. Commissioner,* 22 F. (2d) 6; *Robichaux v. Commissioner,* 32 F. (2d) 780; *Powers v. Commissioner,* 34 F. (2d) 255. The court below at least nine times in its opinion similarly characterized the fund as "the guaranty fund" (R. 57, 58, 60, 63) and also referred to the loss as "the loss of a guarantor" (R. 62). Our position is also well within the scope of paragraphs 5,

6, and 7 of the original assignments of error (R. 19).

So much for the facts. A "guaranty" by its very nature inevitably contemplates liability or obligation, and yet we vainly search the Government's petition for certiorari or either of its briefs for even the slightest reference to that aspect of the case. There is nothing but reference after reference to the taxpayer's "right" to share in the proceeds and to his "property", his "property interests", and his "property right." All of which may be true, for even a guarantor has rights. But it is far from the painting of a complete picture. The transaction was essentially and through all the years one of guaranty *and the Board has so found.* A guaranty is essentially an obligation, and the principles applicable to such transactions have become quite well established in a line of cases to which we will briefly refer. These decisions indicate beyond question that a loss of a guarantor or endorser is sustained wholly and only when the transaction is finally closed, and thus fully support the decision of the Circuit Court of Appeals that in the present case March 1, 1913, is not a controlling date nor March 1, 1913, value an essential factor.

The case most closely in point on its facts is that of *McLeod v. Commissioner*, 19 B. T. A. 134. McLeod was a stockholder and director in the Fidelity Trust Company which the Massachusetts Commissioner of Banks in 1920 took over and proceeded to liquidate. A substantial part of the assets were sold to the Liberty Trust Company under an agreement whereby the liquidation of a part of the assets so purchased should be in the hands of a board of trustees, and if the total amount realized should exceed the obligations and liabilities assumed by Liberty such excess should

be distributed among the stockholders of Fidelity. One of the conditions of the agreement was that a *guaranty fund* of $400,000 should be raised by the stockholders and deposited with the trustees. This condition was complied with and for several years there seemed to be hope that the assets would be liquidated at an amount which would enable the trustees to refund to the subscribers to the guaranty fund a portion of the amount of their subscriptions. McLeod paid approximately $20,000 on his subscription to the guaranty fund, the principal payments being $5,000 in October, 1923, $8,000 in April, 1924, $4,500 in October, 1924, $1,000 in November, 1924, and $1,000 in January, 1925. The first of these payments was an initial cash payment, and the others were in payment of notes which he had given as security for the balance of his subscription. McLeod claimed a deduction in his fiscal year ending June 30, 1925, for the loss on his subscription to the guaranty fund. The Board said at page 138—

> "The respondent contends that any loss which the petitioner sustained with respect to his subscription to the guaranty fund was a loss in the fiscal year ended June 30, 1924, and that no part of that loss may be allowed either as a bad debt deduction or as a loss in the fiscal year ended June 30, 1925."

After holding that there was no debtor or creditor relationship between the trustees and McLeod the Board continued at page 139—

> "The respondent has determined that the petitioner sustained no loss upon this transaction in the fiscal year ended June 30, 1925. The peti-

tioner has adduced evidence to the effect that he had not ascertained that he had sustained a loss in respect of his subscription to the guaranty fund until May or June, 1925. But an ascertainment of a loss within a taxable year is not the criterion imposed by the statute for a loss deduction. Losses are deductible under the statute only in the year when *sustained.* The evidence here does not show, in the language of the Supreme Court in United States v. White Dental Mfg. Co., 274 U. S. 398, the occurrence in the fiscal year ended June 30, 1925, of "indentifiable event" which fixed a loss deductible from gross income. *If the evidence showed the liquidation* by the Liberty Trust Co. or of the trustees *of the assets of the Fidelity Trust Co.* taken over *and a deficiency resulting from that liquidation in the taxable year under review, it might be that the loss suffered by the petitioner would thereby be identified as a loss sustained in the taxable year.* But the respondent has determined that the loss was sustained in a prior taxable year. The evidence offered does not prove or tend to prove error on the part of the respondent in making such determination. The contention of the respondent is therefore sustained."

In that case it was held that a guarantor's loss on a subscription to a guaranty fund is sustained when and only when the transaction is finally closed by liquidation of the assets guaranteed. There was no talk of "rights" or of "property" in that case, and no more need there be in the present case. The Board clearly recognized that a deficiency resulting from the liquidation of the assets was the measure of the loss, and that the loss was sustained when that liquidation took place. It so happens that all the events in the *McLeod* case were subsequent to March 1, 1913,

but even had the guaranty fund been created before that date the principle announced by the Board would necessarily exclude the application of any March 1, 1913, value theory, the very essence of which is that a part of the loss had already been sustained by that date. If the principles decided in the *McLeod* case apply in the case of a guaranty fund when the result of their application is favorable to the Government, they would seem equally applicable in the present case.

The case of *Dillon v. Commissioner*, 9 B. T. A. 174, is perhaps even more closely in point in its principle. There the Board allowed a loss as a deduction to certain guarantors when they made a payment of $28,000 in accordance with a later agreement under which that payment was to be made in full release of their liability under an earlier guaranty. In that case as in the present case the guaranty was finally closed out in *accordance with* a supplemental agreement, and the Board held that the loss was deductible *when and only when the matter was finally closed.* As it said at page 180 in the case of guarantors of stock values (and the present contributors were in the same way guaranteeing the values of the Segal matters)—

> "Under such facts, losses are not realized until the corporation becomes insolvent or the stock worthless * * * *A guarantor's loss depends upon whether the obligations guaranteed proved to be worthless in whole or in part.*"

These two cases make it plain that in the case of a guaranty the loss is sustained—not from time to time as the matter proceeds and hence measured by com-

parison with a March 1, 1913, value—but only when it is closed by final and irrevocable settlement of the guarantor's liability. Until then there is no loss at all. Usually the final settlement is by a cash payment, but the form is a mere incident and not a substantial or controlling factor. The mere fact that, as here or as in the *McLeod* case, the cash may have been previously paid subject to refundment to the extent not eventually needed, can obviously not be the determining factor. This is in full accord with another well established line of cases giving effect in one form or another to the basic principle that for income tax purposes it is immaterial which party may actually hold the custody of funds pending final determination of who is entitled thereto. *Bugher v. Commissioner,* 9 B. T. A. 115; *Reizenstein v. Commissioner,* 9 B. T. A. 1184; *C. R. I. & P. Rwy. Co. v. Commissioner,* 13 B. T. A. 988. Cf. also *Southern Pacific Company v. Lowe,* 247 U. S. 330, 337.

That a March 1, 1913, value is not a factor in a case of a loss by a guarantor or endorser, and that such a loss is wholly sustained in the year when the matter is finally closed even though both the endorsement and the insolvency of the debtor occurred prior to March 1, 1913, is specifically held in a published ruling of the Commissioner of Internal Revenue. We refer to A. R. R. 479, reported in Internal Revenue Cumulative Bulletin No. 5, page 146.

In that case the taxpayer had endorsed certain notes of the corporation and as a result of the corporation becoming insolvent had become liable as endorser for payment of the notes. *All of this happened prior to March 1, 1913.* He did not, however, make any settlement on account of this liability, either

in cash or in his own notes, until 1917, and in that year he deducted as a loss the amount which he then paid. The Income Tax Unit disallowed the loss on the ground that the payments were made in liquidation of a liability incurred prior to March 1, 1913, or in other words that the loss was sustained prior to that date, just as in the present case the Government argues that Mr. Houston's loss was sustained prior to that date. But the Bureau's Committee on Appeals and Review, in a ruling approved and officially published by the Commissioner of Internal Revenue, held—

> "In the opinion of the Committee, A suffered no actual loss through his indorsement of the said notes until he made his first payment in liquidation of their principal and interest thereon. When a payment was made it created a debt in his favor due from the makers of the notes, which debt was at the time it was created definitely known to be worthless and uncollectible. Each additional payment created an additional bad debt.
>
> In view of the foregoing the Committee recommends that the action of the Income Tax Unit in disallowing the deductions claimed by A for the years 1917, 1918 and 1919 to cover amounts paid in liquidation of the said notes and interest thereon be reversed, and that the said deductions be allowed in the amounts as claimed."

In other words, this ruling absolutely confirms our position that such a loss is for income tax purposes sustained in its entirety only when the matter is finally closed either by payment or by final release of all or part of amounts already in the custody of the other party. It is apparent that in the case of

the taxpayer in A. R. R. 479 the value of any "rights" that he might have had in the matter on March 1, 1913, was just as negligible as the value which the Government seeks to attribute to Mr. Houston's "rights" at that date. The Government has however, through its duly authorized agency ruled that the theory of March 1, 1913, valuation does not apply in such a case, and unless it was clearly wrong in that case—and we feel sure that it was not—it cannot now be heard to argue that such a theory is applicable in the present case.

Let us assume for a moment that the income tax had been in effect as long ago as 1906, and ask ourselves the question whether any of the subscribers to the guaranty fund had sustained any loss on account of the Segal matters either in that year or at any time prior to March 1, 1913? The answer must obviously be a negative one. The Segal matters still belonged to and continued to belong to the Real Estate Trust Company. They were still being administered by that company, and continued to be so administered until many years after 1913. During many of those years there was still substantial ground and hope that the Segal matters would liquidate at or even in excess of the value guaranteed by the subscribers. In the event of that happy outcome the subscribers would never sustain any loss. It would indeed be a stretching of theory to its very breaking point to say, as the Government now claims before this court, that a guarantor's loss, which is admittedly not deductible until his account with the guaranty fund is closed, should nevertheless be limited to the value of his "right" on a date years earlier when

there was no sure way of knowing whether there would ever be any loss.

Or to look at it another way. If in 1906 Bayard Henry had merely guaranteed the Segal matters up to $42,500 without actually putting up the cash until 1921, when to use the words of the Board in the *Dillon* case "the obligations guaranteed prove to be worthless * * * in part," and had then paid up his loss of $36,950, would there be any question that the entire loss was both sustained and deductible in that year? Nor can there be any real question here. The guiding principles applicable to cases of guarantors or endorsers have been too well settled in such decisions of the Bureau of Internal Revenue and of the Board of Tax Appeals as those which we have quoted. It has apparently been unnecessary for the higher courts to pass upon them except in just such isolated cases as those now before this court where the initial decision was out of line with the general trend of the decisions of the Bureau and of the Board. We venture the suggestion that the principles expressed and embodied in the rulings cited will be found by this court to be so sound and convincing that there will be no occasion to disturb the judgment which has been entered in this case by the Circuit Court of Appeals.

Respectfully submitted,

JAMES CRAIG PEACOCK,
Counsel for Mrs. J. I. R. Henry, Executrix of the will of Bayard Henry, deceased.

GERALD RONON,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

No. 199.—October Term, 1930.

David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Samuel F. Houston. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 13, 1931.]

Mr. Justice Sutherland delivered the opinion of the Court.

The question in this case arises under § 214 (a) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1066, 1067, the pertinent part of which is as follows:

"Sec. 214 (a). That in computing net income there shall be allowed as deductions:

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, . . ."

The respondent, in making his tax return for 1920, claimed a loss incurred in a transaction entered into in the year 1906, by which he acquired certain rights of the character, and in the manner, hereafter stated. The Commissioner of Internal Revenue disallowed the claim, and his determination was sustained by the Board of Tax Appeals upon the ground that the taxpayer had failed to show the value of the rights as of March 1, 1913. 13 B. T. A. 279. Upon a petition for review the Circuit Court of Appeals upheld the claim and reversed the action of the Board of Tax Appeals. 39 F. (2d) 351.

The following are the facts: In 1906, owing to excessive loans made to Adolph Segal, the Real Estate Trust Company of Philadelphia closed its doors, and a receiver was appointed. Segal had deposited collateral, which possessed an "uncertain value" and could not readily be liquidated. A plan of reorganization was proposed by the receiver, which, among other things, contemplated the creation of a fund of $2,500,000 to be subscribed by directors of the company to guarantee a value of $3,000,000 for the Segal collateral—designated in the plan, "Segal matters". The

subscribers to the fund were to receive any excess over the amount of $3,000,000 which might be realized from the administration of the "Segal matters." No limit of time was put upon the administration, or upon the final disposition, of the assets embraced by the "Segal matters." The plan became effective and the company resumed business on November 1, 1906; and thereafter, and until December 30, 1920, the "Segal matters" were administered under the exclusive direction of the president of the company, who theretofore had been the receiver.

The respondent, a director of the company, was a subscriber to the fund in the sum of $305,000. At the time of the subscription respondent believed that the "Segal matters" had a potential value which could be converted into a sum sufficient to repay the subscribers the amount of their subscriptions with interest, and possibly some profit. The president, then receiver, expressed to the directors the same belief.

Included in the Segal collateral were certain bonds and shares of stock of the Pennsylvania Sugar Refining Company. At the time the subscriptions to the guarantee fund were made, there was in contemplation the bringing of a suit in behalf of that company against the American Sugar Refining Company under the Sherman Anti-trust Act; and the value of the "Segal matters" depended to some extent upon the successful prosecution of this suit. In fact, two suits were brought, one in a federal district court for $10,000,000, and another in a state court, the latter on the ground that an agent of the American Sugar Refining Company, had made an agreement in restraint of trade with Segal. The litigation was compromised in January, 1910, upon the delivery to the Real Estate Trust Company by the American Sugar Refining Company of certain bonds, among which were bonds of the Pennsylvania Sugar Refining Company. In 1912, the latter were converted into 7,268 shares of stock in a reorganization called Pennsylvania Sugar Company. Some question having arisen in respect of the rights of the subscribers, on May 5, 1916, a supplemental agreement was made to the effect that when the 7,268 shares of stock in the Pennsylvania Sugar Company were disposed of, the contributors to the guarantee fund should receive one-fourth of the proceeds. These shares, at that time, and for a period prior thereto, constituted the principal unliquidated assets of the original "Segal matters."

In 1920, the parties concerned having concluded that the remaining Segal assets would not soon increase in value, the subscribers entered into agreements providing for complete liquidation of the "Segal matters," and, thereupon, for the distribution of one-fourth of the Pennsylvania Sugar Company stock to the subscribers in proportion respectively to the amounts of their subscriptions, in full satisfaction of all agreements relating thereto. Respondent, accordingly, received 222 shares of Pennsylvania Sugar Company stock, the fair market value of which was $150 per share. Upon that basis, respondent, in 1920, wrote off his books a loss of $271,700, a sum arrived at by deducting $33,300, the value of the stock received, from $305,000, the amount of his original subscription. In his return for 1920 the amount was deducted as a loss.

We assume, for the purposes of the case, that, within the meaning of § 214 (a) (5), the facts establish a transaction entered into for profit by the subscribers to the fund of $2,500,000. In this view each subscriber acquired an interest in the amount which might be realized in excess of $3,000,000 by the administration and disposition of the "Segal matters". Such an interest falls within the meaning of the term "property." See *Townsend* v. *Ashepoo Fertilizer Co.*, 212 Fed. 97, 101; *Samet* v. *Farmer's & Merchants' Nat. Bank*, 247 Fed. 669, 671; *Presbrey* v. *Simpson*, 290 Fed. 333, 335. Tested alone by the fact that the cost to respondent in 1906 of his portion of this interest was $305,000, and the fact that by the final settlement of 1920, he received only the sum of $33,300, the result was an actual loss to the extent of the sum claimed. But this is not enough. Section 202 (a) of the Revenue Act of 1918, supra, provides:

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; . . ."

Under this provision, it is necessary to consider not only the cost of the interest acquired by respondent in 1906, but also its fair market price or value as of March 1, 1913; and whichever of these is found to be the lower must be taken as the basis for de-

termining the loss resulting from the final disposition of the property. In other words, the effect of the provision in respect of value on March 1, 1913, is to limit the deductible loss by that value if it be less than the original cost. This is the effect of the prior decisions of this court. *United States* v. *Flannery*, 268 U. S. 98, 103, and cases cited; *Heiner* v. *Tindle*, 276 U. S. 582, 587. And see *Nichols* v. *Smith*, 35 F. (2d) 938, 939; *Black* v. *Commissioner*, 16 B. T. A. 425, affirmed 42 F. (2d) 1013.

The burden of proof to establish a deductible loss and the amount of it, clearly, was upon the respondent. *Reinecke* v. *Spalding*, 280 U. S. 227, 233; *United States* v. *Anderson*, 269 U. S. 422, 443. It was just as necessary under the statute for the respondent to prove value as of March 1, 1913, as it was to prove cost in 1906 and the amount finally received by him in 1920. The court below, after a review of the facts, disposed of the matter by saying:

"To determine, in view of these variable factors, or lack of factors, its true or approximate value on a given date, as that of March 1, 1913, selected by the commissioner as the basis of the tax calculation, was a sheer impossibility. The only fixed factors in the situation were those of cost in 1906 and return in 1920. It follows that the proper basis for measuring the petitioner's admitted loss—because the only possible basis—was that of cost and return."

We cannot agree that the impossibility of establishing a specific fact, made essential by the statute as a prerequisite to the allowance of a loss, justifies a decision for the taxpayer based upon a consideration only of the remaining factors which the statute contemplates. The definite requirement of § 202 (a) (1) of the act is not thus easily to be put aside. The impossibility of proving a material fact upon which the right to relief depends, simply leaves the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof. Compare *Underwood* v. *Wing*, 4 De Gex, M. & G. 632, 660; *Newell et al.* v. *Nichols et al.*, 75 N. Y. 78, 90; *Estate of Ehle*, 73 Wis. 445, 459-460; 2 Chamberlayne, Modern Law of Evidence, § 970.

Neither can the presumption be indulged that the *cost* of respondent's interest in 1906 was the *value* of that interest in 1913, for *non constat* that such cost was the value even in 1906.

Moreover, we think the record is far from demonstrating the impossibility of supplying evidence from which the required fact might be found. The 7,268 shares of stock in the Pennsylvania Sugar Company, the distribution of which in 1920 closed the transaction, had been received by the Real Estate Trust Company as early as 1912. This stock, together with certain bonds, not otherwise described, constituted on March 1, 1913, the entire available assets remaining of the original "Segal matters." There seems to have been no difficulty in ascertaining the value of the stock in 1920; and it is hard to see why its value, as well as the value of the bonds, could not have been, at least approximately, determined as of March 1, 1913, and, consequently, the approximate value of the contingent interest of each of the subscribers to the fund ascertained as of that date. No reason is suggested by the record or otherwise, and none occurs to us, for not seeking light on the subject from those who had been in charge of the liquidation of the "Segal matters". We cannot assume that such an effort would have been fruitless. Respondent was bound to produce the best available evidence of value which the circumstances and nature of the transaction permitted. It does not appear that he made any attempt to do so.

Judgment reversed.

A true copy.

Test:

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